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common law to determine the reasonableness of police activity, it had "'not simply frozen into constitutional law those law enforcement practices that existed at the time of the Fourth Amendment.' . . . Because of sweeping change in the legal and technological context, reliance on the common-law rule . . . would be a mistaken literalism that ignores the purposes of a historical inquiry." Id. (quoting Payton v. New York, 445 U.S. 573, 591 n.33 (1980)). Instead, two critical presuppositions had changed between the Founding and 1985 -- first, unlike at the Founding, few felonies were punishable by death anymore, id. at 13-14; second, "[t]he common-law rule developed at a time when weapons were rudimentary." Id. at 14. The Court held that these changes justified a limitation on the use of force to situations where "such force . . . is necessary to prevent the escape and the officer has probable cause to believe that the suspect poses a significant threat. . . ." Id. at 3. The suspect in Garner was apparently unarmed. Thus, the Court found that the rule permitting the use of deadly force on the fleeing "felon" in Garner was not "reasonable" within the meaning of the Fourth Amendment. Id. at 11.

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8. Nonlegal Presuppositions: Support for Established Religions. -- A third example of translation to account for a change in a nonlegal presupposition is adverted to in a recent article by Michael McConnell, discussing the Supreme Court's Establishment Clause jurisprudence. McConnell notes: "One of the most important eighteenth-century abuses against which the no-establishment principle was directed was mandatory support for churches and ministers." n282 This was an abuse because it was, as McConnell describes it, "support for religion qua religion." n283 Stated differently, the Founders considered this practice abusive for "it singled out religion as such for financial benefit." n284 In a world where government benefits were slight, where the federal government provided essentially no welfare support, any spending that directly benefitted religion would necessarily mean support for religion as religion.

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n282 Michael W. McConnell, Religious Freedom at a Crossroads, 59 U. CHI. L. REV. 115, 183 (1992); see also DEREK DAVIS, ORIGINAL INTENT 47-48 (1991) (describing the broad interpretation of the Establishment Clause as a "no aid" approach).

n283 McConnell, supra note 282, at 183.

n284 Id.

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Upon what did that conclusion -- that mandatory support for churches meant government support for religion -- hang? As McConnell argues, it [*1241] rested upon the presupposition that the government did not generally provide benefits for social services to the nonprofit sector. In that context, aiding religious organizations meant aiding religion since the government aided no one else. n285

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n285 See id.

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But the presupposition that the government aided no one else was, of course, contingent. And by the 1940s, that contingency had radically changed. By then the government provided a wide range of benefits to the nonprofit sector. n286 And thus, when the question whether the government could supply churches just as it supplied nonreligious nonprofit benefit providers was raised after this change, this change should have mattered. Or at least it should have been accounted for somewhere in the Court's reasoning. Instead, as McConnell argues, the change was ignored:

When government funding of religiously-affiliated social and educational services became a constitutional issue in the late 1940s, the Court properly looked back at the religious assessment controversy. But it missed the point. The Court did not notice that the assessments against which the advocates of the disestablishment inveighed were discriminatory in favor of religion. Instead, the Court concluded that taxpayers have a constitutionally protected immunity against the use of their tax dollars for religious purposes. This immunity necessitated discrimination against religion, thus turning the neutrality principle of the assessment controversy on its head. n287

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n286 Id.

n287 McConnell, supra note 282, at 183-84 (footnote omitted).

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McConnell then concludes,

The Court's analysis failed to recognize the effect of the change in governmental roles. When the government provides no financial support to the nonprofit sector except for churches, it aids religion. But when the government provides financial support to the entire nonprofit sector, religious and nonreligious institutions alike, on the basis of objective criteria, it does not aid religion. n288

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n288 Id. at 184 (emphasis in original).

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To determine the difference, the interpreter must look then to the context of the initial determination; and once that context had changed in this significant way, McConnell should agree that fidelity would require a changed application as well.

Thus, the history of the Establishment Clause provides another example of a change that is required to preserve something from the original context. n289 The presupposition here was nonlegal (the amount of [*1242] other spending); given its change, the fidelitist must ask what effect this change would have

had on the original judgments that informed the Establishment Clause. If the meaning of the original proscription hung upon the fact that aid to religion would have been discriminatory (since the government aided no one else), then continuing that proscription when government aid is no longer discriminatory would change the meaning of the original proscription. As many have noted, it would be to transform the First Amendment from neutrality to hostility. n290 Because of its method, this change the one-step would miss; because of its method, this change the two-step must accommodate.

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n289 A similar point is made by Donald Giannella:

[A]ny thoroughgoing effort to interpret the religion clauses of the first amendment by resorting to the original understanding of the authors and ratifiers . . . is apt to be regarded as a misguided, if not dangerous enterprise. . . . For when we turn to Madison's theories concerning religious freedom and non-establishment, we must inevitably find them encrusted with certain implicit assumptions which were products of prevailing social, political, and economic conditions. Doctrinal formulations designed to achieve certain ends may achieve indifferent or perverse results when the assumptions on which they rest change.
Donald A. Giannella, Religious Liberty, Nonestablishment, and Doctrinal Development (pt. 1), 80 HARV. L. REV. 1381, 1383 (1967).

n290 See, e.g., Douglas Laycock, Formal, Substantive, and Disaggregated Neutrality Toward Religion, 39 DEPAUL L. REV. 993, 1003 (1990) (arguing that a formally neutral law, such as Prohibition, can actually lead to religious persecution).

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9. Nonlegal Presuppositions: Abandoning State-Imposed Segregation. -- Finally, and most famously, is the example of Brown v. Board of Education. n291 As an example of translation, it is true to say both that Brown provides the most self-conscious example of translation in light of changes in nonlegal presuppositions, and that nonetheless, its utility to a theory of translation is just slight. No one questions Brown's result (anymore). n292 Indeed, so completely has the legal system reoriented itself after the decision that it may not even be possible to find the legal material with which to mount a serious challenge to its conclusion. In a world where a conservative like Justice Scalia says the correctness of the decision "leaves no room for doubt," n293 it is difficult to reconstruct the world where liberals such as Professor Herbert Wechsler could worry that no principled opinion could be written to support it. n294

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n291 347 U.S. 483 (1954).

n292 Well, almost no one. See, e.g., Graglia, supra note 1, at 1040, 1037-43 ("It is even possible that segregation would have ended more quickly in the deep South without Brown and the ten-year grace period for compliance afforded by the 'all deliberate speed' formula.").

n293 Rutan v. Republican Party, 497 U.S. 62, 95 n.1 (1990) (Scalia, J., dissenting).

n294 See Herbert Wechsler, Toward Neutral Principles of Constitutional Law, 73 HARV. L. REV. 1, 32-34 (1959).

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So overdetermined, thus, Brown may provide no more than a purely negative test of an interpretive theory: no theory of interpretation can [*1243] survive as a theory of interpretation of this Constitution unless it can justify Brown. But as these limitations acknowledged, I still believe there is some utility to exploring whether and how the theory of fidelity sketched above could accommodate Brown.

In Plessy v. Ferguson, n295 the Supreme Court upheld a state statute requiring railroads to segregate passengers on the basis of race. Professor Tushnet has argued that Brown can be understood as a translation of Plessy. n296 Translation explains Brown's result, Tushnet argues, because of the changing importance of education between the two periods. In short he argues that even if it was permissible to segregate schools when they were insignificant, barely state-run, institutions, schools are not that now. n297 As Chief Justice Warren wrote for the Brown Court, "[W]e cannot turn the clock back to 1868. . . . We must consider public education in the light of its full development." n298 Schools now are the very center of state government, as clearly emblems of state action as any state action could be.

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n295 163 U.S. 537 (1896).

n296 Tushnet, supra note 32, at 800-01.

n297 Id.

n298 Brown v. Board of Educ., 347 U.S. 483, 492 (1954).

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But the problem with this argument is that it fails to explain the per curiams of the Court following shortly after Brown itself, in which the Court summarily struck down all forms of de jure segregation. n299 If it was the significance of education that explained Brown, then what was the significance of public golf courses that explained Holmes v. City of Atlanta? n300

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n299 See, e.g., Gayle v. Browder, 352 U.S. 903 (1956) (per curiam) (buses); Holmes v. City of Atlanta, 350 U.S. 879 (1955) (per curiam) (golf courses); Mayor v. Dawson, 350 U.S. 877 (1955) (per curiam) (beaches).

n300 350 U.S. 879 (1955).

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These questions invite a second understanding of the translation in Brown.

Brown changed the application of the Fourteenth Amendment articulated in Plessy. To understand Plessy, it is extraordinarily important to understand the argument with which the Court was confronted. Homer Plessy's argument focused not so much on the social importance of riding in one car or the other; rather, Plessy's argument was about the construction of social meaning and, in particular, the state's responsibility for that construction. Plessy did not complain about the social status of blacks in America in general. He complained instead about the state's responsibility for that social status.

At the center of Homer Plessy's case was a claim about the social meaning of this legally imposed segregation: that the law's support of the [*1244] "social usage" of segregation "confirmed" the inferiority of the "black man's" status. If so, then the social meaning of being black, Plessy argued, was affected by the law's intervention, and affected for the worse. n301 It was for this reason, he argued, that Louisiana was not giving him equal protection of the law -- not because Louisiana did not provide equal access to public accommodations, but because Louisiana was itself contributing to and responsible for the disability of the "black man's" status.

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n301 As attorneys Phillips and McKenney argued the case,

Sir Walter Scott reports Rob Roy as announcing proudly that wherever he [sat], was the head of the table. Everybody must concede that this is true socially of the White man in this country, as a class. Nor does anybody complain of that. It is only when social usage is confirmed by statute that exception ought or legally can be taken thereto. The venom to free institutions comes in just there. A spirit of independence is even nourished in the poor man by observing the exclusive airs of good society. He can return its indifference or its disgust with interest, leaning upon his sense of the impartiality of THE LAW to both. But when law itself pronounces against his humble privileges the case becomes specifically different. What was mere fact yesterday, . . . becomes precedent today. A pernicious down-grade is established.
Brief for Plaintiff in Error at 9, Plessy v. Ferguson, 163 U.S. 537 (1896) (No. 210).

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Justice Brown, writing for the Court, joined issue with Plessy on precisely this point. Like Plessy, he was not concerned with the importance of riding in one carriage versus another. Instead, Justice Brown argued,

We consider the underlying fallacy of [Plessy's] argument to consist in the assumption that the enforced separation of the two races stamps the colored race with a badge of inferiority. If this be so, it is not by reason of anything found in the act, but solely because the colored race chooses to put that construction upon it. The argument necessarily assumes that if, as has been more than once the case, and is not unlikely to be so again, the colored race should become the dominant power in the state legislature, and should enact a law in precisely similar terms, it would thereby relegate the white race to an inferior position. We imagine that the white race, at least, would not acquiesce in this assumption. n302

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n302 Plessy, 163 U.S. at 551 (emphases added).

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Justice Brown believed that Plessy was wrong to believe that the social meaning of being black was affected by anything the state did; wrong to think that the stigma that he suffered was due at all to the actions of the state; and wrong because Plessy's stigma was created by Plessy himself, and thus was fully within Plessy's power to remove. Plessy's stigma was "solely" a function of Plessy's choice and not at all a function of anything the state enactment did. Thus, because the stigma was self-created, it was not a burden requiring remedy under the Equal Protection Clause.

[*1245] Behind Justice Brown's argument is a conception of social meaning that we could call libertarian -- that social meaning is wholly within the control of any individual to construct or reconstruct; that it is, to borrow unfairly from Roberto Unger's terminology, fully plastic n303 not just socially (that is, through collective action), but also individually (through the action of one person alone). Justice Brown claimed that the social meaning of being segregated was plastic in just this sense, n304 and if it were plastic in this sense, then the state would indeed not be responsible for any meaning of stigma attached to segregated train cars.

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n303 See ROBERTO M. UNGER, PLASTICITY INTO POWER 153 (1987) (defining plasticity as "the facility with which work relations among people . . . can be constantly shifted in order to suit changing circumstances, resources, and intentions").

n304 See CHARLES LOFGREN, THE PLESSY CASE 178-79 (1987) (characterizing Justice Brown's conclusion in Plessy as being that "racial instincts exist, and . . . are sufficiently rooted in man's nature as to be impervious to alteration through legal schemes").

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So was Justice Brown's understanding correct? Perhaps one could imagine a time when social meaning was plastic in just this sense, and maybe it was so in 1896, though I doubt it. Nonetheless, none could deny that social meaning was no longer plastic in this sense by 1954. It was (at least) by then clear that, as Justice Harlan argued in Plessy itself, n305 the actions of a government enforcing a separation because of race marked one race with a badge of inferiority, n306 and that the social meaning of inferiority was not constructed, or reconstructable, by any one individual acting alone.

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n305 See Plessy, 163 U.S. at 555-56 (Harlan, J., dissenting).

n306 See Brief for the United States on the Further Argument of the Question of Relief at 6, Brown v. Board of Educ., 347 U.S. 483 (1954) (No. 1).

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Plessy's "fallacy" then became the premise of Chief Justice Warren's argument in Brown: harm in the form of a stigma did flow from the actions of the state, n307 since the social meaning of this stigma was in part state-created. If the stigma was state-created, then the Equal Protection Clause required its elimination, or at least it required the elimination of that part for which the state could be held responsible. So held Brown. n308

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n307 Or at least, reviewing the procedural posture of the case, nothing showed that the finding below of stigmatic harm was false. One could well doubt whether such an important constitutional issue should depend on the fact-finding of a particular tribunal. But the lawyer's appeal to procedural posture has not been so limited. See Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 680 (1981) (Brennan, J., concurring) (arguing against the majority's "supposition that the constitutionality of a state regulation is determined by the factual record created by the State's lawyers in trial court"). Brown itself was understood as a finding of fact (rather than ruling of law) by at least one federal court. See Stell v. Savannah-Chatham County Bd. of Educ., 220 F. Supp. 667, 678 (N.D. Ga. 1963) ("The Court holds that the existence or non-existence of injury to white or black children [from integrated or segregated schooling] is a matter of fact for judicial inquiry and was so treated in [Brown]."), rev'd, 333 F.2d 55 (5th Cir.), cert. denied, 379 U.S. 933 (1964). Obviously the sense in which the finding about the nature of the state's construction of meaning must be a different kind of fact than was spoken of there.

n308 It is of course an important and importantly troubling conclusion from the translation argument for Brown's correctness that it may also imply Plessy's correctness in context. For just this reason, Justice Black rejected the argument. See Harper v. Virginia State Bd. of Elections, 383 U.S. 663, 677 n.7 (1966) (Black, J., dissenting) (arguing that the Brown decision was correct for the same reason Justice Harlan dissented in Plessy: the purpose of the framers of the Thirteenth, Fourteenth, and Fifteenth Amendments was "completely to outlaw discrimination against people because of their race or color").

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[*1246] Now I do not mean to argue that Justice Brown would have converted had we shown him a bit about the construction of social meaning. Brown's opinion in Plessy is obviously overdetermined, and there can be little doubt that had his argument not been available to him, he would have found another. But on its face, the opinion offers a rhetoric that the argument of fidelity can meet. n309 If, as the rhetoric suggests, the decision in Plessy rests on a conception about the social meaning of being black, then Brown's denial of Justice Brown's premise suggests another example of a translation to account for a change in nonlegal presuppositions. In the context of Plessy, taking Justice Brown at his word, if he believed that the state-required segregation was not responsible for any additional harm to Plessy's self-imposed stigmatic harm because social meaning was individually reconstructable, then the notion of individually plastic social meaning was a presupposition of Justice Brown's argument. By the time of Brown, however, that presupposition was certainly

rejected. According to the then-current view about the nature of social meaning, state-imposed segregation was clearly a stigmatic harm for blacks (at the least). In light of that changed presupposition, the application of the Equal Protection Clause had to change. If it changed to accommodate the change in presupposition, then it changed as an act of fidelity. n310

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n309 Thus, I am open to the same charge of implausibility that Professor Klarman raises against Ackerman's isomorphic account of Plessy since "Justice Brown doubtlessly would have reached the same result even if deprived of [the incorrect] premises." Michael J. Klarman, Constitutional Fact/Constitutional Fiction: A Critique of Bruce Ackerman's Theory of Constitutional Moments, 44 STAN. L. REV. 759, 787 (1992) (reviewing BRUCE ACKERMAN, WE THE PEOPLE: FOUNDATIONS (1991)). In response I would argue, as I believe Ackerman must, that the question is not what Justice Brown would have done, but rather what the structure of Brown's justificatory rhetoric is. Justification operates at that level, and not the level of individual psychology. For example, if a defendant successfully justifies the breach of a contract on grounds of impossibility, it is no reply to argue, impossibility notwithstanding, she would have breached the contract anyway and so should be held liable in damages. See also HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-1937, at 288 (1991); cf. Commonwealth Edison v. Allied-General Nuclear Servs., 731 F. Supp. 850, 860 (N.D. Ill. 1990) (Posner, J., sitting by designation) ("'[S]upervening impossibility' -- that is, impossibility arising after the promisor broke the contract -- is a defense."). See infra note 311 for further discussion of Ackerman's argument.

n310 Professor Hovenkamp suggests a similar difference between Plessy's context and that of Brown. As he forcefully argues, each opinion is consistent with the mainstream of social science of its time. Hovenkamp, supra note 252, at 624-26. His explanation, too, could suffice as a justification of a changed presupposition accounting for the differences in outcome between the cases.

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So much shows that a changed presupposition could explain the change from Plessy to Brown. n311 One could ask whether there was a changed [*1247] presupposition between the enactment of the Fourteenth Amendment and Brown -- whether Plessy, that is, was wrong. For most assume that Plessy was consistent with the understanding of the framers of the Fourteenth Amendment, and hence most assume that a consistent one-step would have agreed with the outcome of Plessy. n312 If that is correct, then the centrality of Brown in our interpretive constellation may draw additional support for the practice of the two-step.

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n311 As justification, this analysis might imply that both Plessy and Brown were correct interpretations for their times. The argument is similar in structure to Bruce Ackerman's, as presented in ACKERMAN, supra note 309, at 149. What distinguishes the two arguments is the difference in the presupposition said to change: Ackerman claims the changed presupposition was a conception about the proper role of an activist government; I claim that the changed presupposition was the conception of race and stigma. Compare id. at 146-48

with supra notes 306-10 and accompanying text. See also Klarman, supra note 309, at 786-87 (describing Ackerman's "nifty" argument that "[m]odern commentators miss the possibility that both cases [Plessy and Brown] were correctly decided . . . because they fail to appreciate that the Constitution was amended in 1937"). This difference is significant, since Ackerman's requires the pedigree of democratic change, while mine does not.

n312 See RAOUL BERGER, GOVERNMENT BY JUDICIARY 126-27 (1977) (noting that an attempt to require state constitutions to provide a nondiscriminatory public school system failed soon after the Fourteenth Amendment was passed); Alexander M. Bickel, The Original Understanding and the Segregation Decision, 69 HARV. L. REV. 1, 58 (1955) (suggesting the Fourteenth Amendment was not originally meant to apply to segregation); Richard A. Posner, Bork and Beethoven, 42 STAN. L. REV. 1365, 1374-76 (1990) (describing Bork's position that the framers of the Fourteenth Amendment did not intend to bring about social equality).

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Nonetheless, it is not important for my purposes to resolve whether the conventional wisdom about the original meaning of the Fourteenth Amendment is correct, or whether, as Michael McConnell now forcefully argues, the conventional wisdom about the original meaning is flatly wrong. n313 For as I hinted at the start, the focus of the two-step's method is incremental. The charge of justification comes when there is an apparent change, which Brown was relative to Plessy. And it is sufficient here, then, to suggest how Brown could be justified relative to Plessy. All the better if it need not confront Plessy's embarrassment.

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n313 Michael W. McConnell, The Fourteenth Amendment: A Second American Revolution or the Logical Conclusion of the Tradition?, 25 LOY. L.A. L. REV. 1159, 1164-68 (1992) (arguing against the view that the principles of the Fourteenth Amendment constitute a radical departure from those of the original Constitution); Michael W. McConnell, Originalism and the Desegregation Decisions (1993) (unpublished manuscript, on file with the Texas Law Review).

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10. Nonlegal Presuppositions: Antitrust, Economic Theory, and Mistranslations. -- My final example of translation is the transformation of antitrust doctrine effected by the courts over the century or so that antitrust has had a federal charter. It may also be the best example of the dangers of the practice of translation itself. For the best reading of the story I am about to relate is not a reading of fidelity; indeed, it may be a model of precisely the infidelity that the one-step seeks to avoid. All the more ironic then that the story that follows is the child of judges who are usually [*1248] committed one-steps in the context of constitutional interpretation. n314 But we save judgment to the end, on both the disciples and the discipline.

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n314 These judges, former Judge Bork, Judge Easterbrook, and Justice Scalia, are three I will refer to as members of the "Chicago School." Although Judge Posner is also from the Chicago School, he would not argue that current

antitrust law emerges from any exercise of fidelity to the Sherman Act's framers. POSNER, PROBLEMS, supra note 32, at 289 n.7 (understanding current doctrine not as an act of fidelity to the enactors of the Sherman Act, but as an adaption to "the socially preferable interpretation" of the statute).

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Born in the confusion of a statutory text that -- standing alone -- could not mean what it said, from the start antitrust law has looked outside itself for guidance in applying the proscription of "every" agreement "in restraint of trade" in a way that made sense. n315 As Justice Scalia has explained, the term had a common-law meaning, and the Sherman Act "adopted the term . . . along with its dynamic potential. It invokes the common-law itself, and not merely the static content that the common-law had assigned to the term in 1890." n316

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n315 Sherman Antitrust Act, 15 U.S.C. @ 1 (Supp. III 1991). For a general account of the history of the Sherman Act that treats well its economic aspects, see HOVENKAMP, supra note 309, at 268-95.

n316 Business Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 732 (1988). Why this invocation of the common-law concept embraces the dynamic potential of the term, whereas the location of the common-law concept of "due process of law" or "seizure" does not invoke the dynamic potential of those terms, Scalia does not here explain. See Schad v. Arizona, 111 S. Ct. 2491, 2505-07 (1991) (Scalia, J., concurring) (arguing that, in interpreting the Due Process Clause, "[i]t is precisely the historical practices that define what is 'due'"); California v. Hodari D., 111 S. Ct. 1547, 1549-51 & n.2 (1991) (Scalia, J.) (relying on traditional common-law definitions of "seizure" in interpreting the Fourth Amendment).

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The common law's dynamic potential serves to assure that the statutory proscription continues to make sense. What "makes sense," though, is answered only by reference to a theory; therefore antitrust law has from the start been contingent upon the theory it embraces. As the theory has been transformed, so too has antitrust been transformed. But, as all change does not entail fidelity, we should ask whether this change was a change of fidelity.

Assume for a moment that the framers of the Sherman Act had one ideal in mind: that, as Judge Bork has argued, "Congress intended the courts to implement . . . only that value we would today call consumer welfare." n317 As Judge Easterbrook described that common end chosen by Congress in 1890: "Members of Congress did not see themselves choosing between 'efficiency' and some other goal. The choice they saw was between leaving consumers at the mercy of trusts and authorizing the judges to protect consumers." n318

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n317 Robert H. Bork, Legislative Intent and the Policy of the Sherman Act, 9 J.L. & ECON. 7, 7 (1966).

n318 Frank H. Easterbrook, Workable Antitrust Policy, 84 MICH. L. REV. 1696, 1703 (1986). It may be that it makes no sense to speak of one purpose of the Sherman Act. If this is so, then the sense in which consumer welfare is a coherent limit falls away.

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[*1249] How one protects the consumers and how one pursues the value of consumer welfare are functions of the technology for pursuing welfare -- i.e., economics. Thus for the courts to know which practices and policies make sense as they are pursuing the value of consumer welfare, courts must look to the technology of economics.

The problem is that the guide of economics itself has not remained constant. n319 At first, the Sherman Act tracked a moralistic conception of the operation of the market; but as economics developed, so too did its application to legal doctrine change. From its beginning as a doctrine of moralism rather than economics (e.g., attacking good or bad competition, trust busting), n320 the antitrust doctrine came to incorporate more explicitly the objective of promoting competition itself as a means of advancing consumer welfare. n321 The last decades have seen the pinnacle of this progress, as the Department of Justice itself has adopted guidelines that track explicitly economic effects in allocating its own enforcement resources. n322 Easterbrook summarizes the result: "Modern antitrust law is a search for economic explanations of problematic conduct." n323

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n319 Easterbrook, supra note 318, at 1702 ("Economists in 1890 thought that cartels were inevitable, maybe even desirable, and dismissed the Sherman Act as political puffery. Not until the 1930s did the economic profession claim to have a partial equilibrium model of monopoly and oligopoly." (citations omitted)).

n320 See id. at 1702-03; supra text accompanying note 318.

n321 See Easterbrook, supra note 318, at 1698 n.7 (citing cases in which the Supreme Court has utilized an antitrust approach strongly influenced by consumer welfare).

n322 This change occurred first in the merger context. See Department of Justice Merger Guidelines (released May 30, 1968), reprinted in ABA ANTITRUST SECTION, MONOGRAPH NO. 7, MERGER STANDARDS UNDER U.S. ANTITRUST LAWS 209, 209 (1981) (establishing that the primary role of enforcement "is to preserve and promote market structures conducive to competition" and focusing on market structure chiefly because the conduct of individual firms in the market tends to be controlled by the structure of that market).

n323 Frank H. Easterbrook, Comparative Advantage and Antitrust Law, 75 CAL. L. REV. 983, 983 (1987).

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For the two-step, so much change appears quite unproblematic, especially as it turns on the discretion to allocate resources in prosecution. Here a

statute that almost by necessity forced a focus outside itself has been applied in radically different ways as the doctrine it tracked (welfare) came to be understood differently (since economics was different). The transformation fits precisely the structure of translation: applying a context-dependent text differently as presuppositions of that context undergo radically important changes. According to this conception, then, one could well understand the history of antitrust law as the selection of alternative means to a common end, where the means chosen depend upon the context of choice, and the context of choice includes both the values Congress selected (protecting consumers) and the facts of the world (conceptions of economics). And so conceived, the history of antitrust doctrine provides [*1250] yet another example of translation accounting for changes in nonlegal presuppositions.

But as I said at the start, all this hangs either on the claim that the value entrenched by the framers was consumer welfare, or on the claim that the framers intended to delegate to the courts the power to choose the policy values that the statute would advance. For if the value chosen by the framers was "concern for farmers, laborers, or small businessmen" n324 then the path pursued by the courts has been unfaithful to those values. And if unfaithful to those original values, then the courts are guilty of infidelity unless empowered to select new values.

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n324 See Bork, supra note 317, at 26.

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As to the first possibility -- that the framers chose consumer welfare as the underlying value of the Sherman Act -- the Chicago School stands on weak ground. n325 Historians have forcefully argued that, at best, there was a broad mix of ideals that underlie the Sherman Act's enactment, none of which stand firmly enough to trump all others. n326 And if this is true, then the translations effected in the name of welfare may be technically perfect, but begin from a forged original. If antitrust was not singlemindedly focused on consumer welfare, translations that presume that it was fail fidelity.

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n325 See Bruce Ackerman, Robert Bork's Grand Inquisition, 99 YALE L.J. 1419, 1423 n.18 (1990) (reviewing BORK, supra note 57) (accusing Bork of having selective perception of the Sherman Act's legislative history); Herbert Hovenkamp, Antitrust's Protected Classes, 88 MICH. L. REV. 1, 22 (1989) ("Not a single statement in the legislative history comes close to stating the conclusions that Bork drew."). But see Robert H. Lande, Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged, 34 HASTINGS L.J. 67, 151 (1982) ("The antitrust laws were enacted to become broad and flexible economic mandates to improve 'consumer welfare,' as Congress defined this term.").

n326 See Hovenkamp, supra note 325, at 21-22 (arguing that high consumer prices, injuries to competitors, and concern that successful firms may be condemned as illegal monopolists were all prominent in the minds of the Sherman Act's framers).

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But maybe the charge to the federal courts was not just to carry on the common-law progress of restraint of trade, but also to select the values that the antitrust doctrine was to advance. Perhaps Congress meant for the courts to decide, between consumers and laborers, who should prevail. And if so, then the final selection of consumers as the courts' chosen victors would not be the manifestation of infidelity, at least to Congress's original intent, but the implementation of Congress's delegated authority.

In the Parts that follow, I develop what may be an independent reason for a court focused on fidelity to disavow just such a power -- the power to select the values to pursue. For now it is enough to see that the fidelity of the antitrust doctrine may hang on precisely this (otherwise scandalous) claim of judicial authority. Thereby do we also see the potential for translation's abuse. Whatever the virtue of the current antitrust doctrine, it may reveal the clearest vice of the translator's practice.

[*1251] VI. Two-Step Fidelity: Limits on Equivalence

As I have already pleaded, these ten examples are not offered for their truth -- little hangs on whether in fact each describes a proper translation. Instead they are offered to sketch a pattern of argument, one consistent, I have argued, with a commitment to fidelity under one conception of meaning and change, and common, I suggest, throughout our legal culture. n327 Arguments certainly remain for rejecting these particular translations. But the reason they stand together here is that whatever their ultimate weaknesses individually, all are at least understandable as illustrations, rather than violations, of a principle of fidelity.

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n327 Other examples of arguments based explicitly on something like the model of translation sketched here include Justices Kennedy and Souter's approach to defining a "public forum" for purposes of the First Amendment. See International Soc'y for Krishna Consciousness, Inc. v. Lee, 112 S. Ct. 2711, 2718 (1992) (Kennedy, J., concurring) ("We have allowed flexibility in our doctrine to meet changing technologies in other areas of constitutional interpretation . . . and I believe we must do the same with the First Amendment."); see also Amar & Widawsky, supra note 78, at 1359 (translating slavery); Donald Elliott, Why Our Separation of Powers Jurisprudence Is So Abysmal, 57 GEO. WASH. L. REV. 506 (1989) (translating separation of powers); Eskridge & Ferejohn, supra note 32, at 523 (translating Article I, Section 7); Note, Rethinking the Incorporation of the Establishment Clause: A Federalist View, 105 HARV. L. REV. 1700 (1992) (translating the Establishment Clause after incorporation).

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Of the aspects of translation that I suggested would guide the two-step fidelitist, however, we have so far touched on just one -- the creativity required to effect a translation. This no doubt is the empowering aspect of the practice, and suggests the potential for vast interpretive reconstruction. It no doubt also raises the conservatives' nightmare of activism run rampant. For nothing offered so far suggests how a practice of two-step fidelity could

restrain the legal interpreter, in just the sense of restraint ordinarily understood by "judicial restraint." n328 Indeed, nothing yet shows whether translation could accommodate practices of restraint.

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n328 There are of course two importantly distinct conceptions of restraint: structural and judicial restraint. See POSNER, supra note 3, at 207-15. I address the latter. For the argument that "any defensible theory of constitutional interpretation must demonstrate that it has the capacity to control judges," see Robert H. Bork, The Constitution, Original Intent, and Economic Rights, 23 SAN DIEGO L. REV. 823, 825 (1986).

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But we have not yet completed the instruction that translation has to offer. For we have not yet focused on the limitation of humility that I suggested a particular practice of translation might import. In this Part, I explore some of these limitations.

Humility, as I described above, is a constraint on the translator's creativity. n329 In terms of the two-step's practice, if translation functions by accounting for changed presuppositions, humility functions by limiting the scope of the presuppositions that the translator can reckon. For example, if translation could account for changes in presuppositions of [*1252] types A to Z, humility says, "Don't account for presuppositions of types W, Y and Z." Thereby humility limits the range of translations that can be effected, not because accounting for them would not advance fidelity in some sense, but because institutional constraints make this particular kind of change inappropriate for this particular translator to effect. So understood, humility describes a "second best" of fidelity -- a constraint on an ideal of fidelity imposed by the nature of the institution effecting the translation.

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n329 Supra section IV(B)(4).

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As applied to legal institutions, the limitations of humility I describe will be of two sorts, one which I call "structural humility," the other "humility of capacity." Structural humility finds reason to limit the scope of translation in the nature of the presuppositions at issue -- it restricts the extent to which the judge as translator may account for presuppositions of a particular kind. Structural humility says, for example, "Because this is a political presupposition, the judicial branch should not account for it." Humility of capacity, on the other hand, finds reason to limit the scope of translation in the nature of the institution effecting the translation itself -- because of the particular weaknesses of this translator, humility of capacity entails that certain types of presuppositions will remain unaccounted. While the two kinds of constraints are distinct, both point to the weakness of a particular translator (because the translator is the judicial branch, for example, it is unable to make the following translations) relative to a conception of an ideal translator.

One caveat is critical. My purpose in this section is not to endorse or justify any particular restraint of humility. Indeed, I believe that the constraints flowing from capacity should certainly be removed, so long as the institutional limitations described could be corrected. My purpose is instead simply to complete the picture suggested by the approach of the translator. A two-step fidelitist could well insist that a practice of fidelity should admit none of these constraints; but that would require reconceiving of much about the institution, the courts, effecting the translation. All I want to claim here is that a two-step fidelitist could admit at least these constraints, and perhaps more, as limitations on the scope of translation. Whether limitations of humility should be accepted, and ultimately what those limitations should be, is a question beyond the scope of this essay. It is enough here just to suggest why they could be incorporated into a conception of fidelity in translation.

A. Translative Limits: Structural Humility

Begin with the limitation of what I will call structural humility. As I discussed the term in the context of literary translation, humility requires that a practice of translation not "improve" the material translated; that it carry the weaknesses of the original text as well as the strengths into its [*1253] new context. n330 We have already seen the somewhat controversial place this ethic holds in traditional translation. n331 The controversy there requires us to justify any role it might have in the two-step's practice.

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n330 Supra notes 148-53 and accompanying text.

n331 Supra note 148 and accompanying text.

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One possible justification has already been hinted at. As I have described it so far, the predicate for a change of translation is a change in a "presupposition." A presupposition changes whenever the original text would have been different, had that presupposition been different when the text was authored. But so defined, should the two-step effect a translation whenever a presupposition changes?

Consider one example. It was a presupposition of the Founders' Constitution that a bicameral legislature was "best." Many modern constitutional democracies do not follow this model. n332 This may indicate that bicameralism is no longer considered "best," and if it is no longer best, then the presupposition relied on by the Founders has changed. If it has changed, then a two-step could ask, what would the Framers have done had they not thought bicameralism best? The answer to that question could be that the Framers would have embraced unicameralism; if so, the two-step could argue, a translation of the Framers' conception into the current context (where bicameralism is no longer thought best) would be to erase bicameralism.

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n332 Bulgaria, Costa Rica, Denmark, Finland, Greece, Honduras, Hungary, Liechtenstein, The Netherlands Antilles, New Zealand, Malta, Portugal, Rumania, Russia, Slovakia, Sweden, and Zimbabwe are all constitutional democracies with

unicameral legislatures. See THE 1993 INFORMATION PLEASE ALMANAC 172-296 (Otto Johnson et al. eds., 1993).

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Now clearly something has gone wrong, but not because the example does not fit the form of the two-step's practice. Instead the example forces us to ask whether, although fidelity requires accommodation for some changed presuppositions, it follows that fidelity requires accommodation for all changed presuppositions. Is it possible that within a particular translative practice some changed presuppositions should not be accounted for by a translator, depending upon the kind of presupposition at issue?

Translation need not be so unlimited, but to see why, return to the basics of humility. The constraint of humility says a translator is not to make the translated text "better." When we enjoin a translator from making a text better, we can understand this as a decision about the kind of judgment for which the author will be held responsible. And from the relativity of translation and equivalence sketched above, it follows that the kind of judgment is a function of the practice at issue. A better text for a poet is one that improves the poetry, thus it is fine if the translator improves the handwriting. A better text for a child is a neatly written text, thus it is not fine if the translator improves the handwriting. What [*1254] humility requires, then, is a claim about the background understanding of what it is the author is being held responsible for. Against this background, humility counsels the translator to stay clear of presuppositions that touch the author's responsibility.

The role of humility is tied to a particular institutional or practical understanding -- an understanding of the institution within which translation functions -- and whether humility is required depends upon that understanding. A two-step fidelitist could embrace structural humility if there were a reason to assure a clear division of labor between the author (Congress or the Founders) and the translator (judges). And of course it is not absurd to claim that our legal culture requires precisely this division. If any part of the agency conception of judges is correct -- the presupposition, remember, of the enterprise of fidelity itself n333 -- it follows there is something the principal is to do that the agent should not. And if so, it would follow that there would be a protected domain of judgments that a translator should not invade. The question becomes how best to identify and insulate this protected domain.

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n333 See supra note 158 and accompanying text.

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As a first step to identifying the domain of protected presuppositions that humility requires judges to ignore, let me give these presuppositions a name. Those presuppositions that humility requires the judge to ignore I will call "political." The intuition behind the category should be obvious -- these are presuppositions that, between the judicial and legislative functions, seem clearly to be within the domain of the legislative. But a definition more precise than this is hard to conclude. One attempt, suggested by Roberto Unger, would focus upon what it was those who constructed the original text

considered themselves to be battling over. Presuppositions within that terrain constitute the political, and without it, nonpolitical. n334 But I want to explore a second way of conceiving of the distinction between political and nonpolitical presuppositions, one that focuses more upon our collective sense about the nature of the presupposition. This collective sense is, of course, not natural or unchangeable; I rely only upon it not seeming changeable at the moment.

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n334 Roberto M. Unger, Lecture III of the Storrs Lectures at Yale Law School (1987) (tape on file with the Texas Law Review).

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By political I mean just this. A presupposition is a fact or belief that, were it otherwise, would have resulted in a different text. Obviously, there are at least two very different senses in which a presupposition "could have been otherwise." One is that it could have been false, though once thought to be true (e.g., a conception of law as naturalistic). Another is that it could no longer be thought desirable or best. By political presupposition, I mean a presupposition that is acknowledged because, in the sense just [*1255] described, it is best rather than true. The claim of structural humility is that such presuppositions should not be accounted for in translation.

This distinction, between presuppositions that are acknowledged because they are viewed as best and those that are acknowledged because they are viewed as true, is no doubt hard to maintain. For of course what is viewed as best is a function of what is viewed as true; and what is viewed as true is a function of what is viewed as best. More importantly, the distinction rests not on some philosophical claim about the nature of the presuppositions themselves, but rather on the rhetoric about those presuppositions contingently available to speakers within a particular legal culture. My claim is just that at a particular time, there will be some propositions that will be considered truth propositions, and some that will be considered value propositions, and that the more a proposition seems to be a value proposition rather than a truth proposition, the less the translator constrained by structural humility may account for it.

We have already seen one relatively clear example of this distinction when discussing current antitrust doctrine. n335 As I said there, if we conclude that consumer welfare was not the dominant political idea motivating the framers of the Sherman Act, then we must either conclude that the courts have not acted with fidelity in construing the act as they have, n336 or that Congress gave to the courts the power to select which value the Sherman Act was to protect. Tracking these values would be an example of translation that accounted for political presuppositions in the sense I describe, and the claim is that structural humility may provide reasons why a court should resist such assignments.

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n335 Supra section V(B)(10).

n336 Whether the courts have acted sensibly is a separate question.

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But consider a second example that may make the distinction more clearly. n337

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n337 A third example may be Justice Douglas's notion of the different conceptions of equal protection fit:

> We agree . . . with [Holmes] that the Due Process Clause of the Fourteenth Amendment "does not enact Mr. Herbert Spencer's Social Statics." Likewise, the Equal Protection Clause is not shackled to the political theory of a particular era. In determining what lines are unconstitutionally discriminatory, we have never been confined to historic notions of equality, any more than we have restricted due process to a fixed catalogue of what was at a given time deemed to be the limits of fundamental rights. Notions of what constitutes equal treatment for purposes of the Equal Protection Clause do change.

Harper v. Virginia State Bd. of Elections, 383 U.S. 663, 669 (1966) (citations omitted) (emphasis in original).

The two-step constrained by structural humility would argue that if it is a conception of equal protection that has changed, and if the conception has changed for political reasons, then the Court should not adjust the constitutional notion of equal protection to track this change.

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In County of Riverside v. McLaughlin, n338 the Supreme Court revisited the question of how long police could hold a warrantless arrestee [*1256] without presenting her to a magistrate. Earlier, in Gerstein v. Pugh, n339 the Court had held that the presentation must be made "promptly"; n340 the question presented in Riverside was how "prompt" was promptly enough. n341 In a closely divided vote, the Court held that forty-eight hours was presumptively promptly enough. Over a stinging dissent by Justice Scalia, the Court, through Justice O'Connor, held that as long as the reasons for the delay of forty-eight hours were not illegitimate, forty-eight hours was not an unreasonable delay. n342

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n338 111 S. Ct. 1661 (1991).

n339 420 U.S. 103 (1975).

n340 Id. at 125; see also Riverside, 111 S. Ct. at 1665 ("In [Gerstein], this Court held that the Fourth Amendment requires a prompt judicial determination of probable cause as a prerequisite to an extended pretrial detention following a warrantless arrest.").

n341 Riverside, 111 S. Ct. at 1665.

n342 Id. at 1671.

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There are at least two distinct issues raised by Riverside: first, what reasons justify a delay, and second, given a delay for those reasons, how long can that delay be? What is striking about the case for our purposes is the sharp line drawn between these issues: for the former question -- what reasons for delay are justifiable -- reflects what I have called a political presupposition (what is best), and the latter question -- how long can police delay when faced with justifiable reasons -- reflects something close to what I have called a nonpolitical presupposition (what is a reasonable amount of delay for these reasons).

In his dissent, Scalia made the point most sharply. The Fourth Amendment had constitutionalized the common law, Scalia said, at least to the extent that the only legitimate reasons for a delay in presenting a warrantless arrestee to a magistrate were those reasons recognized at the common law. n343 Those reasons included only the time necessary to bring the arrestee to a magistrate, and not, for example, the delay necessary to conduct further investigation. n344

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n343 Id. at 1672 (Scalia, J., dissenting).

n344 Id.

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But while the reasons for delay were frozen at the time of the Founding, such that no further reasons or justifications for delay would survive, the length of the delay allowed by those reasons was a function not of what the delay would have been at the common law, but a function of what the delay should reasonably be today, given today's technology. Scalia put it much better than could I:

> The Court dismisses reliance upon the common law on the ground that its "vague admonition" to the effect that "an arresting officer must bring a person arrested without a warrant before a judicial officer 'as soon as he reasonably can' provides no more support than does[Gerstein's] "promptly after arrest" language. . . . [*1257] This response totally confuses the . . . constitutionally permissible reasons for delay with . . . the question of an outer time limit [for a delay]. The latter -- how much time, given the functions the officer is permitted to complete beforehand, constitutes "as soon as he reasonably can" . . . -- is obviously a function not of the common law but of helicopters and telephones. But what those delay-legitimating functions are -- whether, for example, they include further investigation of the alleged crime . . . -- is assuredly governed by the common law. . . .n345

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n345 Id. at 1673 n.1 (Scalia, J., dissenting) (emphasis in original).

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Given the legitimate reasons for a delay, set, again, by the common law, it was not the common law that set how long those legitimate reasons could delay. As Scalia said, that turned not on the technology of the common law, but on

the technology of today -- on "helicopters and telephones." n346

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n346 Id. (Scalia, J., dissenting).

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The distinction Scalia points to here is the distinction between the political and nonpolitical presuppositions that I adverted to above. Choosing which reasons were legitimate was to choose or acknowledge presuppositions because they were best at the time. Choosing how long those reasons could reasonably delay a presentation was to choose or acknowledge presuppositions because they were true at the time. When the latter presuppositions no longer are true, then the conclusions that rest upon them must be translated. Structural humility would suggest, however, that the translator should not adjust presuppositions that change because they are no longer viewed as best. n347 Tracking and accommodating changed presuppositions about what is best is a task assigned, the two-step could argue, to political branches. n348

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n347 Now again I confess the wholly artificial sense of the distinction between presuppositions selected because best, and those acknowledged because true. Riverside itself reveals the inherent ambiguity: for certainly the reasons viewed as best were in fact viewed as best in part because of how long it took to satisfy them. It could then be argued that if, for example, a simple procedure that advanced an investigation could be performed in fifteen minutes, that a view of what reasons were "best" would also include that investigative procedure. Nonetheless, the separation in function between our understanding of the judicial and political branches leads to a separation in translations: the political branches -- since unconstrained by the limitation of translation -- will effect a different translation of the original meaning; and the judicial branches, since constrained by this structural limitation of humility, will effect translations that do not fully account for the change in presuppositions. That, it could be argued, is the whole idea: where political ideals change, where the view of the good is transformed, then political machinery is to be invoked, and thus is the judicial machinery disempowered.

n348 Here again Scalia may be helpful:

A democratic society does not . . . need constitutional guarantees to insure that its laws will reflect "current values." Elections take care of that quite well. The purpose of constitutional guarantees . . . is precisely to prevent the law from reflecting certain changes in original values that the society adopting the Constitution thinks fundamentally undesirable. Scalia, supra note 77, at 862 (emphasis in original); see also Ollman v. Evans, 750 F.2d 970, 1038 (D.C. Cir. 1984) (Scalia, J., dissenting) ("[T]he identification of 'modern problems' to be remedied is quintessentially legislative rather than judicial business. . . . [R]emedies are to be sought through democratic change rather than through judicial pronouncements that the Constitution now prohibits what it did not prohibit before."), cert. denied, 471 U.S. 1127 (1984); State v. Cannon, 190 A.2d 514, 517 (Del. 1963) (arguing that whether whipping is constitutional should not be determined by the judiciary, but rather by the legislature, which can reflect the will of the people about the meaning of "cruel and unusual").

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[*1258] To the extent, then, that a presupposition is a presupposition because it is acknowledged as best rather than because it is acknowledged as true, structural humility would suggest the translator not account for changes in such presuppositions, and this again for reasons internal to the particular institution of judicial review.

If structural humility were the practice of the two-step fidelitist, then it would provide us a way to distinguish the practice of the two-step fidelitist from the practice of others who have at times invoked something like the rhetoric of translation. Such a practice of fidelity would not be a practice by which one derives the "perfect constitution" n349 because it would not adjust for flawed political judgments even if flaws were recognized. Nor would it transform the Constitution to accord to the current "best moral theory" n350 because, again, some moral presuppositions would be political in the sense described above. Nor would it discard a statute merely because unsupported by a current congressional majority n351 since [*1259] this is the core of any political presupposition. The product of the fidelitist is not guaranteed to be the best possible political product, and, humility would suggest, an important measure of the integrity of the practice is the extent to which it permits blemishes to remain, left for the political branch to correct.

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n349 See Henry P. Monaghan, Our Perfect Constitution, 56 N.Y.U. L. REV. 353, 357-58 (1981) (criticizing those who uniformly derive "perfect" results from the Constitution).

n350 See RONALD DWORKIN, LAW'S EMPIRE 397-99 (1986) (positing a system of "constitutional integrity," in which judges base their decision on the best available interpretation of American constitutional text and practice as a whole, an interpretation that explicitly includes political morality). Note, too, that in this way the approach of the two-step is distinct from Eskridge's. Eskridge does not attempt to distinguish among the kind of changes that empower a court to permit a statute to "evolve" -- in his scheme, the change could be factual or not. Nor is he concerned with the need to assure some form of constancy in meaning across such evolution. See Eskridge, supra note 32, at 321-22 (arguing that "under any rigorous theory of statutory interpretation, legislative supremacy not only tolerates, but requires judges to interpret statutes dynamically -- that is, in ways not contemplated by the original drafters"); see also William N. Eskridge, Jr., Dynamic Statutory Interpretation, 135 U. PA. L. REV. 1479, 1479 (1987) (insisting that statutes should be interpreted "dynamically," that is, in light of their present societal, political, and legal contexts). But what distinguishes an approach of translation from other dynamic theories is the attempt to limit the kinds of facts that justify the interpretation's evolution. While the approach here is certainly "dynamic," it is dynamic in its effort to preserve meaning rather than evolve. If evolution means advancing politics or morality, then the translator wants to remain backward. Such advances are the domain of political, not judicial, departments.

n351 Compare CALABRESI, supra note 32, at 118 (discerning that one option when deciding who should bear the burden of inertia in lawmaking is to force

legislation to be reapproved to remain in force) with William H. Rehnquist, The Notion of a Living Constitution, 54 TEX. L. REV. 693, 696-97 (1976) ("A mere change in public opinion since the adoption of the Constitution, unaccompanied by a constitutional amendment, should not change the meaning of the Constitution."). Of course, that was precisely the Court's justification for the change the Court undertook two Terms ago in Payne v. Tennessee, 111 S. Ct. 2597, 2608 (1991) (stating that "social consensus" about the death penalty's relation to certain offenses is a limit imposed by the Eighth Amendment).

In this way, at least, the approach sketched here is distinct from Calabresi's far more ambitious and insightful effort. It is distinct in a second way as well. Calabresi does not engage the possibility that fidelity requires change when presuppositions change. He presumes, along with the traditional debate, that change based on changed presuppositions is just bad interpretation. Such an approach, he suggests, does "violence" to legislative intent or language and to "the core of honest interpretation." CALABRESI, supra note 32, at 35.

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It is particularly instructive to compare the practice of the two-step fidelitist and the practice described by Dworkin as "Law as Integrity." n352 For Dworkin, much of the practice of the judge of integrity is the practice of translation so far described. n353 The judge is to make sense of a past practice through the dimension of "fit" first. n354 But always, and essentially, there is a gap: a question that does not fit past practice, and hence a question that the judge must face, as it were, on her own. Here, Dworkin suggests, the judge is to resolve the question in light of the "best moral theory" then existing, resolving it in the way enlightened moral sensibility would then resolve it. n355

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n352 See generally DWORKIN, supra note 350, at 176-275.

n353 Dworkin describes, for example, an "aesthetic hypothesis" that guides and constrains the practice of interpretation, distinguishing interpretation from "change." See RONALD DWORKIN, A MATTER OF PRINCIPLE 149 (1985).

n354 See DWORKIN, supra note 350, at 255 (noting that "[c]onvictions about fit will provide a rough threshold requirement that an interpretation of some part of the law must meet if it is to be eligible at all").

n355 See id. at 255-56 (noting that if more than one interpretation survives the "fit" inquiry, the judge "must choose between eligible interpretations by asking which shows the community's structure of institutions and decisions . . . in a better light from the standpoint of political morality").

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The two-step fidelitist would reject Dworkin's conception. n356 Although the two-step agrees that at times there are gaps, she is not allowed to make changes that turn on changing or current moral or political presuppositions. Tracking morality, or political correctness, is the duty of the political branch; structural humility, the duty of the translative branch. n357 [*1260]

Structural humility requires that the judge maintain an old-fashioned obstinacy to questions in that gap, in part adopting a practice that is the inverse of Dworkin's, by resolving the question as if the political presuppositions were as they were when the text being applied was authored -- willfully blind to the currently best moral theory, and embracing instead the original moral or political theory, at least where not later altered by the political branch. Again, the translator's duty is to carry over the warts; the author's or her assign's duty is to erase them. In this way the practice of the two-step could stand between the originalist and the phantom the originalist most forcefully attacks -- the proctor of that "continuing national seminar . . . in moral philosophy." n358 From the perspective of the two-step fidelitist, both the originalist and the Dworkinian are infidels.

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n356 The two-step would also reject similar conceptions, such as those discussed in Harper v. Virginia State Bd. of Elections, 383 U.S. 663, 669 (1966) (tracing how interpretation of the Equal Protection Clause has changed throughout history); Robert W. Bennett, The Mission of Moral Reasoning in Constitutional Law, 58 S. CAL. L. REV. 647, 647-48 (1985) (comparing constitutional interpretations that call for "moral reevaluation and possible moral growth" in only individual rights cases with those calling for such moral interpretation in all cases); Thomas C. Grey, Do We Have an Unwritten Constitution?, 27 STAN. L. REV. 703, 705 (1975) ("It seems to me that the courts do appropriately apply values not articulated in the constitutional text, and appropriately apply them in determining the constitutionality of legislation."); Sandalow, supra note 32, at 1053 ("The values that have informed decisions under the equal protection clause, as under the due process clause, are those that each generation has thought appropriate to its time.").

n357 From this assertion flow the well-known refrains. See Posner, Statutory Interpretation, supra note 32, at 818 ("It is not the judge's job to keep a statute up to date in the sense of making it reflect contemporary values; it is his job to imagine as best he can how the legislators who enacted the statute would have wanted it applied to situations that they did not foresee.").

n358 Gerard E. Lynch, Constitutional Law as Moral Philosophy, 84 COLUM. L. REV. 537, 549 (1984) (reviewing MICHAEL J. PERRY, THE CONSTITUTION, THE COURTS, AND HUMAN RIGHTS (1982)).

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Finally, we should be clear about one important restriction upon the limit of structural humility. Compare the following two ways in which moral values may underlie a particular text. In the first, a legislature proscribes an act because it is considered immoral -- fornication, for example. In the second, a legislature delegates to a court the task of enforcing a law that embraces explicitly current moral understandings -- the Mann Act, for example, which forbade transporting a "woman or girl" to engage in a group of listed activities or "any other immoral practice," could be understood as a command to track what purposes are now deemed immoral. n359 In the first case, humility would counsel that a translating court ignore the changed views about the morality of the proscribed act -- if, for example, fornication was no longer considered immoral, humility would counsel the court ignore that change. n360 In the second case, humility would have no necessary role. For in the second case, the command

includes updating to account for changed moral views, and to update according to that command is not to make the statute "better"; rather it is simply to keep the statute the same. The limit to this practice would be a limit of separation of powers, not humility.

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n359 See 18 U.S.C. @ 2421 historical notes (1988). This language was removed in 1986. Id.

n360 This analysis is distinct from the analysis pointed to by Daniel Farber when discussing the cy pres doctrine. Farber, supra note 32, at 310. Farber discusses Lesbian/Gay Freedom Day Comm., Inc. v. INS, 541 F. Supp. 569 (N.D. Cal. 1982), in which the court "declined to enforce a clear congressional mandate that homosexuals be excluded from entry into the country because Congress had acted on the outmoded understanding that homosexuality was a psychiatric disorder." Farber, supra note 32, at 310 n.149. One could distinguish a changed view about the morality of homosexuality from a changed view about its pathology. Humility would constrain accounting for the former change, but not the latter.

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[*1261] Structural humility thus constrains the practice of the interpreter, again for reasons internal to the practice of the institution within which translation functions. As sketched above, the constraint would limit the range of presuppositions that the translator could account for in a translation. The translator may account for all presuppositions -- save the political. n361

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n361 In this way, the two-step constrained by a practice of structural humility may resemble the method of originalism endorsed by Robert Bork. Bork concedes the need to permit constitutional law to "evolve" to adjust to, among other things, changing technology, but resists evolution to adjust to changes in politics. See BORK, supra note 57, at 167-70; see also Ollman v. Evans, 750 F.2d 970, 995-96 (D.C. Cir.) (Bork, J., concurring) (equating changes in First Amendment libel doctrine (in response to a changing culture) to changes in Fourth Amendment doctrine (in response to the technological invention of wiretapping)), cert. denied, 471 U.S. 1127 (1984).

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B. Translative Limits: Capacity

Thus far the limits on the translator's practice have derived from the nature of the presuppositions accounted for: structural humility limits the range of presuppositions because it is inappropriate for a court to account for this type of fact. But inappropriateness of type does not exhaust the reasons that a translator may have for refusing to effect a translation. Even if a presupposition is of a type that is appropriate for a translator to account, the very judgment required in the translation may be far too complex for the translator to complete. This possibility suggests the second dimension of humility -- one that looks to the translating institution itself and limits

the scope of presuppositions because the kind of judgment required would exceed the institution's ability.

This second limitation of humility, then, is a limitation of capacity, a recognition of the inability of a court as currently structured to account for certain kinds of changes in presuppositions, either because the material at issue is itself too complex, or because the resources necessary to track them are too great. While the plea of incapacity has been a frequent one over the courts' history, n362 and one we have already seen when discussing the Tenth Amendment, n363 it is nonetheless a persistent (and perhaps exaggerated) one, and its persistence suggests its possible place in the two-step's analysis.

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n362 See, e.g., New York v. United States, 326 U.S. 572, 581-82 (1946) (recounting the plaintiffs' argument that any decision as to immunity from federal income tax is beyond the capacity of the courts because it "brings fiscal and political factors into play").

n363 Supra notes 221-22 and accompanying text.

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Here is just one example. One way to understand the Court's unwillingness to police the boundaries of interstate commerce is the Court's incapacity to make judgments about the actual effects of legislation on interstate commerce. Once beyond the categories of the nineteenth-century formalist, the Court quickly saw, as Cardozo warned, that every subject of regulation would eventually have some effect on interstate commerce, so [*1262] that in principle no clear line could be drawn. Judge Posner describes Cardozo's view:

Every economic activity, however local, affects interstate commerce because of the chain of substitutions that connects all activities in a national economy. But Cardozo recognized that to infer from this that Congress could regulate all local activity would wreck the balance between state and federal regulatory power that the Constitution had struck in empowering Congress to regulate interstate and foreign -- not all -- commerce. He though a line should be drawn that would, however crudely, balance the competing values of nationalism and localism. n364

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n364 RICHARD A. POSNER, CARDOZO: A STUDY IN REPUTATION 122 (1990).

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It would seem to follow from this, were fidelity the Court's sole aim, that the Court would strive, as Cardozo counseled, to find some workable line dividing interstate from intrastate commerce, if only to find some way to preserve the Constitution's division of power. Yet, since the New Deal, the Court has abstained from just such policing, n365 no doubt in part because of the political nature of the judgment made (a reason of structural humility), but also perhaps because of the complexity of the judgment required (a reason of capacity). Under the latter reading, the Court was unwilling to second-guess Congress's determination, in part because it was in no better position to

judge the actual economic effects of legislation that form the predicate for Congress's action than was Congress itself. Whether or not Congress could or did make the judgment, for the Court to make it would require it to engage an inquiry far beyond its institutional ability. Or at least the Court could so claim. And if this was the justification for its refusal to engage in substantive review of the limits on Congress's power, then this refusal would constitute a defense of necessity to the charge of infidelity -- a refusal grounded in incapacity.

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n365 The Court abandoned its earlier attempts to make distinctions between intrastate and interstate commerce when it adopted the economic effects test for Commerce Clause questions in 1937. See NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 40 (1937) (noting that, for purposes of deciding the constitutionality of the National Labor Relations Act as applied to a steel plant's labor practices, the relevant question is the effect of the labor practices on interstate commerce).

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One final but critical feature distinguishing this type of humility must be noted. Humility grounded in incapacity is contingent in a way that humility grounded in the nature of the presuppositions accounted for is not. If fidelity is constrained by a limit of incapacity, then the fidelitist has a strong argument for institutions that eliminate this limitation of capacity, and thereby advance an objective of fidelity. But without this remedy, the limitation based on capacity provides a second way in which the structure of the judiciary limits the scope of fidelity.

[*1263] C. Two-Step Fidelity: The Model Summarized

We are in a position to draw together the model of two-step fidelity.

Both the one-step and two-step fidelitist begin the practice of fidelity with a contextualized understanding of the text being read. For both, the question is, "What was the meaning of the text when written?" Unlike the one-step, however, the two-step is sensitive to the effect of context in both the context of writing and the context of reading, or the context where the "text" is the application. Thus in the two-step's view, fidelity requires that the meaning of the application in the context of reading be as close as possible to the meaning of an original application in the context of writing. Thus does the two-step adopt a practice designed to preserve meaning across contexts, and that practice I have called translation.

Translation moves in two steps. First, the two-step becomes familiar with both the context of writing and the context of application, so that she has a sense of what I have called the character of each. Second, she seeks an equivalent in the application context to the original application in the authoring context. To identify those cases where a translation must be made, she adopts a method of analysis. First, she identifies changes in presuppositions between the two contexts. (Again, not all changes are changes in a presupposition; only a change that would have resulted in a different text in the originating context counts as a change in a presupposition.) And if a presupposition has changed, then second, she may be required to accommodate

that change, by making the smallest change possible in the outcome or reading to preserve the most possible from the original context.

May, and not must. For despite a changing presupposition, the translator may be required to do nothing. A principle of humility may require her to ignore the changed presupposition, either if it is what I have described as a political presupposition, or if accounting for the change of that presupposition would exceed the institutional capacity of the two-step translator. Either way, values other than fidelity might trump that ideal of fidelity, and for these values, the two-step must allow the text translated to fall out of tune.

VII. Conclusion

Readings of the Constitution have changed, but standing alone, that says nothing about fidelity. Readings of the Constitution have remained the same, but again, standing alone, that says nothing about fidelity. Changed readings are neither necessary nor sufficient conditions of infidelity or fidelity. So much I have tried to argue.

There is a practice of interpretation that could conceivably meet a legal system's demands for fidelity. That practice is one I have called [*1264] translation. Translation is distinct from one-step originalism. For reasons tied to how meaning changes across contexts, one-step originalism as a practice must systematically defeat any ideal of fidelity. Blind to the effect of context on meaning, originalism allows context to change constitutional meaning.

Unlike one-step originalism, arguments from translation accommodate changes in context so as to preserve meaning across contexts. These arguments are familiar to the law, and have been made by jurists spanning the political spectrum. Where they have been limited, I have identified two types of limits, structural humility and humility of capacity, that may explain these constraints -- constraints serving values other than fidelity. But beyond these, or to the extent the fidelitist could escape these, the fidelitist, I have suggested, would translate.

Thus one-step fidelity is distinct from two-step fidelity, but depending upon the constraints of humility, it might be that we consider both to be forms of originalism. What two-step fidelity adds to our ordinary understanding of originalism is a way to understand how originalism can be dynamic without it being unfaithful. What it also may add is a way to distinguish the emerging originalist jurisprudence of the middle Justices of the current Supreme Court. For what distinguishes the practice of originalism of at least Justices O'Connor and Kennedy, and perhaps Justice Souter, n366 is its attention to issues that I would identify as issues of translation. Justice Kennedy, for example, has attacked the one-step originalist position of Justices Scalia, Thomas, and Rehnquist on the meaning of the "public forum" doctrine, arguing:

In a country where most citizens travel by automobile, and parks all too often become locales for crime rather than social intercourse, our failure to recognize the possibility that new types of government [*1265] property may be appropriate forums for speech will lead to a serious curtailment of our expressive activity. n367

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n366 Consider his quite striking description of Brown in his confirmation hearings:

There certainly was no intent whatsoever in the enactment of the 14th Amendment to bring about school desegregation. And if in fact the meaning or the guarantee of equal protection were confined to specific intent, then of course, Brown . . . would have been a wrong decision. But my interpretive position is not that original intent is controlling, but that original meaning is controlling.
The Nomination of David H. Souter to Be Associate Justice of the Supreme Court of the United States: Hearings Before the Comm. on the Judiciary, United States Senate, 101st Cong., 2d Sess. 161 (1990).

He later continued:

The majority who decided Plessy v. Ferguson in 1896 accepted as a matter of fact that in the context in which they were applying the 14th Amendment there could be separateness and equality. Whatever else we may see in Brown v. Board, there is one thing that we see very clearly and that is that the Court was saying you may no longer . . . ignore the evidence of non-tangible effects. When you accept that evidence, then you see that you cannot have separateness and equality.
Id. at 303.

n367 International Soc'y for Krishna Consciousness, Inc. v. Lee, 112 S. Ct. 2711, 2717 (1992) (Kennedy, J., concurring). According to the one-step position adopted by Chief Justice Rehnquist, public forums -- that is, those in which the government is most limited in the regulations it may impose -- were just those and only those traditionally considered public forums. See International Soc'y for Krishna Consciousness, Inc. v. Lee, 112 S. Ct. 2701, 2706 (1992).

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Likewise, and perhaps more significantly, in Planned Parenthood v. Casey, Justices O'Connor, Kennedy, and Souter offered an account of why two past Supreme Court reversals -- Brown's reversal of Plessy, and the Court's change after the New Deal -- were justified as acts of judicial fidelity in the face of changed understanding of fact. n368 As I discuss with respect to Brown, n369 to see such a change as nonetheless a change of fidelity requires an understanding consistent with the two-step's, and inconsistent with the one-step's. The one-step can only see the reversals of Brown and the New Deal as infidelity, however that infidelity is justified.

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n368 Planned Parenthood v. Casey, 112 S. Ct. 2791, 2812-13 (1992). The Casey Court noted that during the Lochner era, the Court's decisions regarding economic regulation were based on a laissez-faire theory of contractual freedom; the eventual repudiation of Lochner and related cases, the Court said, was justified by "the clear demonstration that the facts of economic life were different than those previously assumed." Id. at 2812. Similarly, the Casey Court noted that the holding in Plessy v. Ferguson, 163 U.S. 537 (1896), was based on a factual assumption -- that separate did not imply inferiority -- that was repudiated in Brown v. Board of Education, 347 U.S. 483 (1954). Casey, 112 S. Ct. at 2813.

n369 Supra section V(B)(9).

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Two-step fidelity may then help map the currently emerging conservative middle. But does it show whether we should be fidelitists? For if anything, by sketching what fidelity is not (originalism), and suggesting something it might be (translation), we have only made plain an intuition present from the start of this Article: that perhaps the best picture of a practice of fidelity is a picture of a practice beyond our reach. We may understand enough to see what fidelity would be, but also enough to see why it is beyond what we could hope to achieve.

To put these aspects of skepticism into context, we must distinguish between two very different uses of arguments from translation, one negative, the other positive. The negative is this: We find ourselves now surrounded by a myriad of interpretations of a Constitution generations old. Some of them were interpretations of fidelity, some certainly not. The question for a fidelitist reviewing any past interpretation is whether it is an interpretation of fidelity. But as should be clear, fidelity is not binary. There will be more and less faithful, not faithful and unfaithful, readings. So in evaluating a reading, evaluation must always proceed by comparison (i.e., is this reading more faithful than that?).

[*1266] In this comparison, the originalist presumed that the original reading would always trump any later interpretation. We have seen enough to see why this is not necessarily true. Indeed, as we get further removed from any original context, even a presumption in favor of an original reading may disappear: We may be so removed from that context that their applications presumptively may be not our own. But regardless of any presumption, the originalist's restoration must be compared with the current reading, and the question becomes whether the alternative is more faithful than the status quo.

Well, again, the originalist reading will not be more faithful simply because it was the original application. Its claim to fidelity must be made by showing that it -- though identical with the original application -- is the best translated application in light of the many changes in context between the original time and now. Faced with such a burden, the originalist aiming to restore original meaning faces a difficult task. As the changes in context multiply, the difficulty of that showing increases as well, and with increased difficulty goes a decreased likelihood of success. The originalist fails to demonstrate the original is still the faithful reading because demonstrating that an alternative is a better translation becomes an impossibly difficult standard to meet.

This suggests the sense in which translation can be used defensively as a shield against a current crusade of restoration organized under the banner of originalism and fidelity. But, in the same way, the argument suggests the weakness of translation as a tool of fidelity used positively -- not as a shield against the crusaders, but as a sword against an interpretive status quo.

For the problem is always that the task of translation itself is despairingly difficult. To translate we must speak another language, which for constitutional lawyers is the language of the eighteenth century, synthesized with the restructuring of the nineteenth century. "Language" is more than

words people use; it is their ideals, their hopes, their prejudices, their enlightenments -- in short, it is their world. As the distance to that world increases, so too does the difficulty of the task of translation, not just in the sense that it becomes more and more difficult to understand who the Framers were, but also in the sense that it becomes more and more difficult to accept what they were about. Wittgenstein wrote, "If a lion could talk, we could not understand him." n370 Can we anymore understand a generation for whom the Nobility Clause n371 was an organizing ideal of original [*1267] design? At some point does it no longer make sense to speak of translation, for at some point the contexts become so different that any understanding between them is lost? And if so, then at some point we must decide whether the enterprise itself -- the enterprise of fidelity -- continues to make sense.

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n370 LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS P 223 (G.E.M. Anscombe trans., 1953).

n371 U.S. CONST. art. I, @ 9, cl.8 ("No Title of Nobility shall be granted by the United States. . . .").

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To this skepticism, there are two standard responses. One is Justice Jackson's. Finding himself in the middle of the constitutional storm over the New Deal, Justice Jackson wrote:

True, the task of translating the majestic generalities of the Bill of Rights, conceived as part of the pattern of liberal government in the eighteenth century, into concrete restraints on officials dealing with the problems of the twentieth century, is one to disturb self-confidence. These principles grew in soil which also produced a philosophy that the individual was the center of society, that his liberty was attainable through mere absence of governmental restraints, and that government should be entrusted with few controls and only the mildest supervision over men's affairs. We must transplant these rights to a soil in which the laissez-faire concept or principle of non-interference has withered at least as to economic affairs, and social advancements are increasingly sought through closer integration of society and through expanded and strengthened governmental controls. These changed conditions often deprive precedents of reliability and cast us more than we would choose upon our own judgment. But we act in these matters not by authority or our competence but by force of our commissions. We cannot, because of modest estimates of our competence in such specialties as public education, withhold the judgment that history authenticates as the function of this Court when liberty is infringed. n372

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n372 West Virginia State Bd. of Educ. v. Barnette, 319 U.S. 624, 639-40 (1943) (emphasis added).

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In Jackson's view, the Court had no choice. Its job, however difficult, was precisely this "translating" even though it acts "not by authority of [its]

competence" as translators "but by force of our commissions" n373 as judges. However impossible, however underdetermined, however political, the Court must, Jackson thought, work to keep the Constitution alive.

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n373 Id. at 640.

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The second tack is simply to confess the impossibility and look elsewhere for constitutional authority, or for substitutes for constitutional authority. This was Brest's response after sketching the outlines of a practice of translation and concluding that any such practice was too hopelessly complex. n374 Because, Brest argued, the counsel of fidelity is so [*1268] unpredictable and unknowable, better to fasten constitutional norms to ideals more familiar and predictable.

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n374 Brest, supra note 32, at 234-37.

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Maybe so. But a third response is also possible, one that looks for ways to rekindle constitutional authority. We come from a tradition when ordinary citizens, as Paine described, would carry copies of the Constitution in their pockets and refer to them in ordinary political debate. n375 We live in a time when almost sixty percent of the American public cannot even identify the Bill of Rights. n376 If the document has become so out of date that its meaning is no longer plain to all -- if it has become impossible to imagine a world where ordinary people carry the Constitution in their pockets -- then perhaps it is time to restore its meaning by, as Justice Stevens has recently suggested, amending the text to preserve the meaning. n377 Perhaps, that is, it is time to rewrite our Constitution, written in a language long lost and forgotten, with ideals and expectations too far from the ordinary ken of constitutional readers, in a language we once again understand, with a meaning that is once again our own. We could struggle to understand what is the most faithful translation, but at some point the question becomes why? We are like the person who finds himself at the store, with a list he can no longer make out, struggling to reconstruct what it must have been that he wanted to buy; at some point it may make sense simply to decide again what he wants, to rewrite the list, to give up the obsession that it must be the same as the old list, to move on.

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n375 In discussing the Pennsylvania Constitution of 1776, Paine writes,

It was the political bible of the state. Scarcely a family was without it. Every member of the government had a copy; and nothing was more common, when any debate arose on the principle of a bill, or on the extent of any species of authority, than for the members to take the printed constitution out of their pocket, and read the chapter with which such matter in debate was connected. THOMAS PAINE, RIGHTS OF MAN 182 (Heritage Press 1961) (1791).

n376 Ruth Marcus, Constitution Confuses Most Americans; Public Ill-Informed on U.S. Blueprint, WASH. POST, Feb. 15, 1987, at A13.

n377 See John Paul Stevens, The Bill of Rights: A Century of Progress, 59 U. CHI. L. REV. 13, 19-24 (1992).

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If fidelity is translation, then perhaps the lesson from the great distance in language is that we have come to the point when a translation of the whole would give us more than translation piece by piece could ever promise. And if not translation of the whole -- if not an effort to recapture and restate constitutional meanings that would be ours -- then perhaps the lesson of the great distance that separates us from the Framers is that fidelity cannot be our aim. Or at least it cannot be our aim anymore.

LEVEL 1 - 76 OF 96 ITEMS

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ARTICLE: Origin of the Blue Sky Laws.

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SUMMARY:
... For more than a generation -- between 1911 and 1933 -- securities sales in the United States were regulated nearly exclusively by specialized state statutes known colloquially as "blue sky" laws. ... Dolley issued a press release to The American Banker boasting that deposits in Kansas state banks had increased dramatically due to the exodus of "blue sky speculators." ... In the words of the counsel for the Michigan Bankers' Association, one of the few individuals associated with state banks to speak out against blue sky legislation between 1911 and 1913, the Michigan blue sky law "can and will stop the Michigan industry which should have immediate financing. ... We find that while there was a public-regarding element to these statutes -- securities fraud undoubtedly did occur during the period in question, and members of the public demanded protection against high-pressure securities salesmen with low business morals -- among the principal determinants of the spate of statutes between 1911 and 1913 was the rivalry between the political coalition favoring Kansas-style blue sky legislation, which included smaller banks, state banking commissioners, and local borrowers, and the coalition opposing such legislation, which included the elite investment houses, the large banks, and bond issuers such as major manufacturing firms, railroads, and public utilities. ...

TEXT:

[*348] I. Introduction

For more than a generation -- between 1911 and 1933 -- securities sales in the United States were regulated nearly exclusively by specialized state

statutes known colloquially as "blue sky" laws. n1 Only with the Securities Act of 1933, n2 adopted by Congress at a time of national economic collapse, did federal regulation begin to any significant extent. And even then federal law was little more than a pastiche of prior experiments in blue sky regulation. n3 Because the Securities Act of 1933 expressly preserved the jurisdiction of state securities commissions, n4 blue sky regulation remained -- and remains today -- a significant part of securities law practice. n5

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n1. For discussion of the origin of the term "blue sky" laws, see infra note 59. There was some federal regulation of securities sales during this period under the postal fraud laws, but the level of enforcement was minimal. See Forrest B. Ashby, Federal Regulation of Securities Sales, 22 ILL. L. REV. 635 (1928) (analyzing defects in the enforcement of postal fraud laws in the securities context, and discussing proposals for a federal blue sky law to remedy the situation).

n2. 15 U.S.C. @@ 77a-77aa (1988).

n3. See generally JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 39-72 (1982).

n4. See 15 U.S.C. @ 77r (1988).

n5. See 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 51-60 (3d ed. 1989). See generally 1 id. at 29-152 (analyzing the history of state blue sky laws and concluding that, since Congress did not eliminate them when it enacted the Securities Act of 1933, it is even less likely to do so now, after over fifty years of dual regulation).

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The origin of the blue sky laws is thus a matter of some historical interest. There is, moreover, a normative element to the analysis. Proponents of mandatory federal disclosure rules cite the adoption and enforcement of blue sky laws prior to 1933 as evidence that securities fraud was a major social problem in unregulated markets. n6 The argument for mandatory disclosure rules would thus be weakened if it were shown that securities fraud was not, in fact, a pervasive problem prior to the advent of specialized securities regulation.

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n6. See, e.g., Joel Seligman, The Historical Need for a Mandatory Corporate Disclosure System, 9 J. CORP. L. 1, 18-33 (1983).

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The standard view among historians is that the blue sky laws represented a response by the political system to serious abuses in securities markets. n7 To combat these abuses, many states adopted [*349] legislation requiring that securities proposed to be sold in a state be submitted to an administrative agency for review as to their "merit" or intrinsic worth. n8 Other states adopted less stringent regulations requiring disclosure of information about the issuer and registration of dealers, but not including merit regulation. n9

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n7. See VINCENT P. CAROSSO, INVESTMENT BANKING IN AMERICA -- A HISTORY 162-63 (Ralph W. Hidy ed., 1970) ("Suffering heavy losses, the victims of these [securities] frauds and misrepresentations agitated for protection, then joined with other dissatisfied midwesterners to elect reform administrations that promised them relief from such abuses."); LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 7-8 (1958) (asserting that blue sky laws grew out of an awareness of "the many instances in which unsophisticated . . . investors had been bilked of their life savings by sellers of worthless or fraudulent securities"); SELIGMAN, supra note 3, at 44-45 (describing Kansas's statute, the first blue sky law, as a response to "the failure of lax state corporation statutes to prevent securities fraud"); Seligman, supra note 6, at 18-33 (citing pre-1934 state blue sky laws as evidence of the fact that securities fraud was considered a serious and widespread problem before enactment of the federal securities acts); Jacob M. Edelman, Securities Regulation in the 48 States (July 1942) (manuscript published by The Council of State Governments) (citing Justice McKenna's opinion in Hall v. Geiger-Jones, 242 U.S. 539 (1917), as a typical justification of state securities legislation as a means of protecting the public from the "evil" of speculative and fraudulent schemes).

Michael Parrish suggests that the blue sky laws sometimes reflected the political influence of local businessmen and securities dealers. Parrish does not develop this thesis in detail, however, and completely misses the principal interest groups supporting the blue sky laws -- smaller banks and state bank regulators. See MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 1-13 (1970). Moreover, we find no evidence to support Parrish's suggestion that local securities firms supported blue sky laws to prevent competition from out-of-state dealers -- most states enacting blue sky legislation did not have a developed securities brokerage industry. See infra text accompanying note 221. And, in any event, the blue sky laws were harmful to the interests of local dealers to the extent that the laws excluded potentially profitable securities from sale within the state, leaving mail and telephone solicitation from out-of-state locations as the only means by which such securities could be distributed. See Robert R. Reed, "Blue Sky" Laws, 88 ANNALS AM. ACAD. POL. & SOC. SCI. 177, 183 (1920).

n8. See JAMES S. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 10, 15 (1971) (characterizing the merit regulation contained in the earliest blue sky laws as an emotional reaction to perceived abuses and noting that the test applied under most merit regulation schemes has evolved from "fair, just and equitable" to one of "reasonableness").

n9. See id. at 11-12 (noting that the general rejection of merit regulation by the commercial Eastern states was based on a fear of inhibiting the formation of "new and risky businesses").

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According to the standard account, this legislation, although unartfully drafted, reflected a more or less spontaneous response by public-minded legislators to a serious social problem. The early state blue sky laws are viewed, under the standard account, as flawed but well-intentioned precursors to the beneficial system of federal regulation adopted by Congress in the

Securities Act of 1933 and the Securities Exchange Act of 1934. n10 Despite the nearly universal acceptance of the standard account of blue sky legislation, however, it is also generally acknowledged that the early history of the blue sky laws has never been studied in depth. n11 Thus, [*350] the view of blue sky legislation presented in the standard account, despite its widespread popularity, has never been fully substantiated.

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n10. See, e.g., Seligman, supra note 6, at 18 (using the standard account of blue sky laws as evidence that the federal securities acts were not merely "a response to financial folklore" or imagined fraud).

n11. See id. at 20 (noting the lack of a comprehensive study of this period); LOSS & SELIGMAN, supra note 5, at 199 ("No comprehensive study of blue sky enforcement between 1911 and 1933 has been produced."); see also Edelman, supra note 7, at 21 (admitting the difficulty of finding statistical evidence to support his allegation that state staff and funds were inadequate to fully enforce state blue sky laws).

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Was there in fact a serious problem with securities fraud in unregulated markets? If there was such a problem, did the blue sky laws represent a spontaneous, public-regarding response by the political system to protect investors against fraudulent securities sales? Were there any vested interests behind the blue sky laws whose goal might have been something other than protecting the public against fraud? Could the blue sky laws have reflected a mixture of special interest pressures and public sentiment?

This study attempts to answer some of these questions with a detailed investigation into the formative period of the blue sky laws -- between 1911 and 1917. We find a history much more complicated than the standard accounts would admit. While frequent complaints about "fraudulent" securities sales persisted in the first decade of the twentieth century, it appears that many of the securities offerings objected to were not so much fraudulent as merely highly speculative. The rhetoric of the times did not distinguish between a security sold through actual fraud and one so highly speculative as to be of questionable value. Similarly, the fact that large amounts of securities were rejected by state officials acting under the authority of the early blue sky laws is not a reliable indicator of the presence of fraud -- both because the officials often enjoyed the power to reject issues solely because they viewed them as bad investments, even if no fraud was involved, and because the officials often had reasons other than the quality of the security in question for preventing its sale within their states. Thus, although fraudulent securities undoubtedly occurred during the early decades of the century, the standard account that securities fraud was rampant before the advent of blue sky regulation is not proven.

The brief spate of blue sky legislation which occurred between 1911 and 1913, moreover, appears due at least as much to chance and to general economic conditions as to the prevalence of, and public revulsion against, fraudulent securities sales. The chance element was the unforeseeable presence of a brilliant and energetic regulatory entrepreneur, J. N. Dolley, who as Kansas Banking Commissioner conceived the idea of blue sky legislation and promoted

it tirelessly within Kansas and across the nation. Economic conditions -- a sustained period of inflation and high nominal interest rates -- threatened the ability of small banks and savings institutions to attract or retain consumer deposits in competition with higher yielding securities and restricted the supply of credit to local borrowers. This threat gave both small banks and local borrowers an interest in suppressing the activities of out-of-state securities firms. As one of us has noted in prior [*351] work, interest group activity generally appears to be greater at times when the interest group is suffering an economic downturn, or the threat of a downturn, than when it is enjoying prosperity. n12 This appears to have held true in the securities context as well.

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n12. See Geoffrey P. Miller, Public Choice at the Dawn of the Special Interest State: The Story of Butter and Margarine, 77 CAL. L. REV. 83, 87 (1989) (stating that "political activity increased in times of adverse economic conditions," and citing as an example the dairy lobby's more intensive efforts when butter prices were low and less intensive efforts when butter prices were high).

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Further, our research reveals that while many proponents of the blue sky laws were attempting to advance the public interest a they perceived it, the statutes themselves were invented, and thereafter promoted in the legislative process, by defined vested interests, including the owners of smaller banks and savings institutions who saw blue sky legislation as a means for suppressing competition for depositors' funds. n13 State banking regulators, interested in protecting and expanding their regulator turf and in advancing the financial interests of banks under their supervision, assisted the small bankers. n14 Other special interests supporting the blue sky statutes were farmers and small business owners who saw the suppression of securities sales as a useful means for increasing their own access to bank credit. n15

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n13. See infra notes 106-19 (discussing the efforts and enthusiasm of non-"money center" financial institutions and state banking regulators in support of blue sky legislation).

n14. See id.

n15. See infra notes 120-27 and accompanying text (discussing support for blue sky legislation from farmers and businesses reliant upon bank credit).

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The principal group opposing blue sky legislation was the nation's elite investment bankers. These bankers had no objection to suppressing speculative securities, which represented as much of a threat to their interests as to small banks and local borrowers. But the investment bankers perceived that the actual purpose and effect of blue sky legislation was not limited to "fly-by-night" operators; these statutes were used to restrict the activities of reputable investment firms as well. n16 Joining the investment bankers in active

opposition to the blue sky laws were large issuers of securities -- which wanted to preserve their ready access to low-cost financing in the public securities markets -- such as railroads, public utilities, and major manufacturing firms. n17 The nation's bigger banks were also generally opposed to blue sky legislation, although, with the exception of banks also engaged in securities underwriting, they do not appear to have engaged in active lobbying on the proposals. n18

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n16. See infra notes 140-49 and accompanying text (discussing the efforts of investment bankers to distinguish themselves from less reputable competitors while simultaneously fighting Kansas-style blue sky legislation).

n17. See infra notes 150-55 and accompanying text (describing opposition to blue sky laws among bond issuers).

n18. See infra notes 176-79 and accompanying text (recounting big bank opposition to blue sky laws).

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[*352] The diffusion pattern of the blue sky laws among the states documents the influence of these different interest groups. By and large, the early, stringent blue sky statutes were adopted in agricultural states without a significant presence of large banks, investment houses, or major manufacturing firms. n19 States with important securities houses or significant manufacturing interests, as well as states competing to attract corporations to charter within their borders, did not adopt stringent blue sky laws. n20

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n19. See infra notes 180-91 and accompanying text (chronicling the passage of blue sky laws in Kansas and other predominantly agricultural states in 1911, 1912, and 1913).

n20. See infra notes 194, 202-05 and accompanying text (discussing the opposition to blue sky legislation in states which were active in the corporate chartering market); infra notes 195, 197-98 and accompanying text (describing the fate of blue sky proposals in several manufacturing states); infra notes 215-20 and accompanying text (detailing the legislative responses in Massachusetts and New York).

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The timing of the blue sky movement also reflects the influence of interest group pressures. The movement to adopt these laws began during a period of relative economic hardship for smaller banks and their borrowers, died down when the securities business fell into disarray in 1914, and remained quiet after the onset of a boom market in 1915 in which all parts of the economy prospered. This evidence tends to substantiate the hypothesis that interest groups are much more likely to seek the help of government in suppressing competition from rival groups when the group seeking protection is suffering hardship than when it is enjoying prosperity.

The blue sky laws, in short, appear to have been formed and adopted through a process of interest group rivalry not significantly different from the process observed in many other legislative contexts. This is not to say that the blue sky laws were solely the product of special interest lobbying, but the evidence does indicate that vested interests played an important role in the adoption of this legislation. The standard histories' picture of the blue sky laws as a spontaneous outburst of public-regarding sentiment, although it captures part of the picture, is thus in need of substantial revision.

II. Speculative Securities Sales in the Early Years of the Twentieth Century

The federal regulation of securities issuance in the United States traces back to the growth of industrial capitalism during the last years of the nineteenth century. A number of factors coalesced to create active public securities markets during this time. n21 The growth of large industries such [*353] as railroads and heavy manufacturing stimulated unprecedented demands for capital. At the same time, increases in wealth among the middle classes n22 created a new source of capital that could be tapped effectively by means of public securities issuance. Development in transportation and communication technology made widespread promotion and distribution of securities practicable. Realizing the potential purchasing power of the rising middle class, bond issuers began to offer securities in denominations of $ 100 instead of the traditional denominations of $ 1,000 or even $ 1,000. n23 A surge of new investment followed. n24

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n21. The discussion that follows applies the "PTML" methodology which we have developed and applied in prior work. This methodology looks at economic history as driven by the dynamic interplay and reciprocal interactions of four great systems -- politics, markets, technology, and law. See David G. Litt et al., Politics, Bureaucracies, and Financial Markets: Bank Entry into Commercial Paper Underwriting in the United States and Japan, 139 U. PA. L. REV. 369, 373-75 (1990) (applying the PTML methodology to bank entry into the commercial paper market in Japan and the United States in order to discover the similarities and dissimilarities between the two economies); Miller, supra note 12, at 129-31 (applying the PTML methodology to the dairy industry's early campaign against margarine); Geoffrey P. Miller, The True Story of Carolene Products, 1987 SUP. CT. REV. 397, 400-15 (discussing Carolene Products in light of the PTML methodology).

n22. National savings quadrupled between 1897 and 1913, growing from $ 790 million to $ 3.69 billion per annum. R. C. MICHIE, THE LONDON AND NEW YORK STOCK EXCHANGES 1850-1914, at 224 (1987).

n23. See Baby Bonds, 77 AM. BANKER 3799, 3799 (1912) (praising the issuance of "baby bonds" for increasing the amount of capital available for development and for enabling the less wealthy to "share in the benefits of current commercial and industrial activity").

n24. See id. (noting that while the individual amounts invested by "holders of small capital" is small, "the aggregate of their total investments [represents] an immense total"). Even women were identified as potential bond buyers. One leading investment house published a flier especially for women, entitled "A Financial Courtship," designed to help women distinguish between

"unsound and speculative propositions" and "investments for safety and income." Investments for Women, 77 AM. BANKER 3095, 3096 (1912).

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Most securities sold to investors during this period were reputable and safe -- the classic examples being railroad and municipal bonds. Interest rates on these securities were low, however. For the investor with a taste for risk, plenty of speculative issues were available in the market. While today's speculative issues are often in high technology fields such as biological engineering, the speculative securities in the early 1900s were typically equity securities issued by mining and petroleum companies, land development schemes (such as irrigation and tract housing projects), and patent development promotions.

Speculative securities were distributed outside the usual channels for blue chip issues. The elite investment banks would not touch them, and they were not listed on the New York or Curb Exchanges, n25 although in the case of mining and oil securities, they often would be listed for trading on the San Francisco, Spokane, or Los Angeles Stock Exchanges. Lacking traditional distribution channels, these securities were marketed by face-to-face [*354] solicitation, newspaper advertisements, and mass mailings. One banking journal described the typical mail promotion as follows:

For some time this office has been pestered with the periodical visitation of the large envelope bearing the usual assortment of yellow dodgers, "confidential" order blanks, donation pool subscription blanks, [and] return envelopes, together with a carefully dictated personal typewritten letter, one-third of which is devoted to an extravagant flattery of the intelligence of the recipient, and the remaining two-thirds to the extolling of the excellent merits of the Gold Hammer Mines and Tunnel Company, from the investment standpoint; after which this most valuable stock is offered at the amazingly low price of seven and one-half cents a share. n26

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n25. The "Curb" Exchange, precursor to today's American Stock Exchange, dealt in securities that were not sufficiently established to warrant listing on the New York Stock Exchange. See SELIGMAN, supra note 3, at 47.

n26. Banking and Mining Shares, 76 AM. BANKER 1336, 1336 (1911).

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Sales of speculative securities surged in the period from 1910 to 1911. The relatively high inflation prevailing during this period n27 spurred investors to seek high-yielding investments such as bonds of smaller railroads, public utilities, and industrial firms. These investments, while still relatively safe, paid as much as 6 percent as compared with blue chip bonds at 4 to 4 1/2 percent. n28 Equity securities offered even greater potential yields -- albeit coupled with greater risk -- while hedging against inflation. n29 Meanwhile a strong agricultural economy from 1910 to 1912 n30 placed disposable income in the hands of the American farmer, who sometimes invested in securities that were as alluring as they were ultimately unwise. n31

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n27. The banking journals contain frequent comments about the high rate of inflation. See, e.g., John C. Shirley, Banking as a Public Trust, 82 BANKERS MAG. 461, 461 (1911) (noting that inflation was the sole cause of high prices and a significant cause of speculation); Frederick Carles et al., The Demand for a Larger Income from Investments, 85 BANKERS MAG. 264, 265 (1912) (noting the prevalence of commentary on the inflated cost of living).

n28. Carles et al., supra note 27, at 265. Customers also became increasingly willing to purchase unlisted securities with the hope of obtaining higher returns. See Listed and Unlisted, 85 BANKERS MAG. 262 (1912) (commenting on the rising demand for unlisted securities).

n29. See I. FISHER ET AL., HOW TO INVEST WHEN PRICES ARE RISING 144 (1912) (noting that in times of rising prices the "most desirable form of investment is one which gives the investor a share in the ownership of a property or enterprise; i.e., stocks, real estate or bonds carrying a stock bonus"); Carles et al., supra note 27, at 265 (discussing investment in higher yielding securities as a buffer to inflation).

n30. See Charles M. Harger, Driving Out the Investment Sharks, 84 BANKERS MAG. 674, 677 (1912) (discussing the rising profits of American farmers); William A. Law, Address of the President, 76 AM. BANKER 1942, 1943 (1911)("The last year has been marked by prosperity among farming interests . . . .").

n31. Many farmers apparently speculated in dubious securities during this period. As one commentator phrased it,

despite the proverbial acumen of the farmer in money matters, a great harvest has been gathered . . . . [A]nd sums running into hundreds of thousands of dollars are cited by the bankers as representing the amount wasted by those who toiled through long years to earn a little surplus for a rainy day. Mortgaged farms even have been a part of the wreckage.

Harger, supra note 30, at 677.

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[*355] The dramatic emergence of financial advertising during the first decades of the century also facilitated securities speculation. Promoters of speculative securities painted their wares in exciting, vibrant tones, stimulating the imaginations of wishful investors with tales of earth-shaking inventions, new projects, and vast wealth. n32 Securities sellers were also among the first to exploit the device of the mailing list -- denigrated by bankers as a "sucker list." n33 For fifty cents each they purchased names of persons who had bought speculative securities in the past and were therefore considered likely prospects for new promotions. n34 All this contrasted vividly with the marketing philosophy of banks and elite securities firms, which disdained all except the drabbest and most unimaginative advertising. n35

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n32. See Euphemia Holden, The Delusion of Sudden Riches: Its Phenomena and Its Cure, 83 BANKERS MAG. 186, 188-89 (1911) (describing speculative

offerings' appeal to the imagination of prospective investors).

n33. H. B. Matthews, The "Sucker List," 86 BANKERS MAG. 174, 174 (1913).

n34. Id.

n35. Cf. Fred W. Ellsworth, Building a Bank's Business, 88 BANKERS MAG. 558, 558 (1914) ("It was only relatively a few years ago when practically all bankers honestly believed that it was unethical to advertise. It was considered the height of treason to the established traditions of the business for a banker to express or display in any way whatsoever a desire for business.").

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The public's growing appetite for speculative securities sparked intense public concern about fraudulent promotions. Speculative securities were typically "hyped" by sales puffery that bordered on misrepresentation -- and undoubtedly sometimes crossed the line. n36 Issues of speculative securities, moreover, were sometimes "watered" n37 by sales to promoters and other insiders on terms more favorable than those offered to the public. n38 The [*356] United States Post Office, acting under the authority of federal postal fraud laws, fuelled public sentiment in favor of stricter regulation by announcing frightening -- although probably inflated -- statistics about the losses to the public from fraudulent promotions, including an unspecified amount of securities promotions. n39 All this was reinforced by existing popular resentment against banks, securities firms, and big business generally -- a prominent feature of progressive politics in the early decades of the twentieth century. n40

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n36. For an example, see Banking and Mining Shares, supra note 26, at 1337 (describing a misrepresentation by a "private banker and broker who, counting upon the influence of the established reputation and prestige of the honest and reliable banker, seeks to peddle his questionable wares among the unsuspecting public").

n37. The metaphor was probably from the dairy industry, where farmers could increase their profits by adding a little water to the milk.

n38. See generally DAVID L. DODD, STOCK WATERING (1930) (discussing the law of stock watering and the principles of judicial valuation of stock). The classic stock watering scheme is illustrated by the famous Old Dominion cases. Old Dominion Copper Mining & Smelting Co. v. Lewisohn, 210 U.S. 206 (1908); Old Dominion Copper Mining & Smelting Co. v. Bigelow, 89 N.E. 193 (Mass. 1909), aff'd, 225 U.S. 111 (1912). Two promoters, Bigelow and Lewisohn, purchased certain mining properties for $ 1,000,000 in an arm's length transaction. Bigelow, 89 N.E. at 197. They subsequently organized a corporation, Old Dominion, and sold it the properties at $ 25/share in exchange for 130,000 shares of the corporation's stock. Lewisohn, 210 U.S. at 210. The properties were then held on the company's books at $ 3,250,000. Bigelow, 94 N.E. at 197. Bigelow and Lewisohn paid over 80,000 of their 130,000 shares to a syndicate of investors who had advanced to the promoters the $ 1 million in funds needed to buy the mining properties. Id. The members of the syndicate thus realized a paper profit of $ 1 million, since they received shares with par value of $ 2 million in exchange for their investment of $ 1 million. This left Bigelow

and Lewisohn holding 50,000 shares, or $ 1,250,000 in paper profits, as recompense for their efforts organizing the corporation. Id. at 198. Bigelow and Lewisohn then issued and sold an additional 20,000 authorized shares to the public, presumably at par. Id. at 197. And, although the cases do not say so, it is evident that Bigelow, Lewisohn, and the members of the syndicate were also busily selling their own stock in the company to the public at the same time. The result of the scam was that the public was duped into buying stock at more than three times the actual value as measured in a nearly contemporaneous arm's length transaction.

One might ask why the investing public was so easily duped. The answer is at least three fold. First, these events occurred during the early days of large-scale securities flotation in the United States. There was not then, as there is now, a well-established group of investment banks and professional securities analysts with expertise in appraising the value of new securities offerings. Thus the public did not have easy access to publicity about the offer which might have warned them off. Second, a responsible investor might well have asked to see the corporation's books before investing. But the books themselves would not have disclosed the scam; the mining properties were held on the books at $ 3,250,000, which supported the par value of the stock. Third, Bigelow and Lewisohn cleverly chose mining properties as the subject of their machinations. Characteristically, a mine's value is hidden in the ground, and thus is not readily observable to investors. Accelerating operations can generate the appearance of large profits in the early years. Bigelow and Lewisohn undoubtedly used the funds received in the corporate treasury as a result of the public stock subscription to step up production and create the appearance of hefty profits while they and the syndicate were selling their stock to the public. Significantly, the wrongdoing did not come to light until seven years after they organized the corporation. DETLEV F. VAGTS, BASIC CORPORATION LAW 53 (3d ed. 1989).

Stock watering proved quite resistant to legal regulation in the early decades of the century. The corporate law rules against self-dealing transactions were not well adapted to controlling stock watering schemes because the corporation, under the control of the promoters, typically consented to the stock sales to the insiders. See Lewisohn, 210 U.S. at 206 (holding that a corporation cannot disregard its previous assent to a stock watering scheme). The "par value" rules of state corporation statutes provided a theoretical remedy against corporate insiders shown to have paid than par value for stock. However, these rules failed on several levels: they were enforceable only by creditors after insolvency, suffered from enormous valuation problems, impaired the marketability of stock, deterred valuable entrepreneurial activity in the formation of new corporations, and were eventually vitiated by "low par" and "no par" stock. See See v. Heppenheimer, 61 A. 843, 846-49 (N.J. Ch. 1905) (demonstrating the particular difficulty in valuing property exchanged for stock); WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 47-49 (1929) (describing the difficulties caused by "par value" and the use of "no par" stock as a more attractive alternative). It would have been possible for chartering states to regulate securities issuance by their domiciliary corporations, but vigorous competition in the market for corporate charters made this regulatory approach impracticable as well. See, e.g., REPORT OF THE COMMISSIONER OF CORPORATIONS, H.R. DOC. NO. 165, 58th Cong., 3d Sess. 40 (1904) (noting the tendency of state legislation "toward the lowest level of lax regulation and of extreme favor toward [speculative promoters]").

n39. See Talks on Thrift, 86 BANKERS MAG. 180, 180 (1913) (reporting the Post Office's estimate that $ 100 million was lost each year due to fraudulent mail promotions).

n40. The Report of the Commissioner of Corporations, published in 1904 and heavily laced with progressive rhetoric, lambasted the existing system of state corporate regulation as lacking in uniformity and tending towards extreme regulatory laxity, and recommended federal licensing of corporations. See REPORT OF THE COMMISSIONER OF CORPORATIONS, supra note 38, at 39-40, 45-46 (noting that a federal licensing system would "reform the present condition of corporate business in all its important features"). Resentment against "Wall Street" and centralized financial power of any sort increased after the Panic of 1907, which was widely attributed to questionable securities speculation. Even the Taft Administration, no enemy of big business, recommended voluntary federal incorporation for industrial firms in 1910 and took on the big investment houses with major antitrust litigation. See 45 CONG. REC. 378-83 (1910) (statement of President William H. Taft); RON CHERNOW, THE HOUSE OF MORGAN 148 (1990) (describing suits filed by the Taft Administration against International Harvester and U.S. Steel, trusts dominated by Morgan). By 1912, Charles A. Lindbergh, Sr. was denouncing the Wall Street "Money Trust," and the House Banking and Currency Committee's Pujo Hearings were attempting to demonstrate the existence of an antitrust conspiracy among the big investment houses. See CHERNOW, supra, at 149-56.

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[*357] Concerns about speculative securities sales were especially pronounced among banks -- organizations which in other respects had little in common with the populist resentment toward Wall Street and financial institutions. As early as 1910 the matter had drawn the attention of the president of the American Bankers' Association, Lewis B. Pierson, whose keynote address to the annual convention that year railed against "get rich quick" schemes, most of which, he said, were nothing more than "impudent and bare-faced swindles." n41 "It is a daily experience at the banks," warned Pierson, "particularly at the savings banks, to have money withdrawn to pay for 'investments' of this character or to meet losses sustained through them." n42

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n41. "Get Rich Quick" Schemes, 81 BANKERS MAG. 609, 613 (1910) (quoting Lewis B. Pierson, Annual Address of the American Bankers' Association).

n42. Id.

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Pierson's theme reappeared frequently in the banking trade journals between 1910 and 1913. Fast-talking securities promoters, said a Bankers Magazine editorial in 1911, were "rogues" who feathered their "gaudy nest[s]" with investors' savings (presumably withdrawn from bank accounts) while attempting to clothe themselves with the bank's reputation for probity by listing a well-known bank as their depository agents. n43 Equally colorful, a speaker at an Indiana bankers meeting disclaimed that "[t]hese high-toned grafters offering bastard securities have seized the spirit of the times and feed upon it like sea gulls on the carcass of a disabled fish." n44 The attempt by securities promoters to

cast themselves as "private bankers," in the view of American Banker, did not "reflect creditably on the general prestige of the profession." n45 Another editorial observed that "probably the Louisiana Lottery was a conservative business enterprise compared with many of the schemes now appealing to the gullible under the guise of "investments.'" n46

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n43. See Using Banks as Decoys for Promotion Schemes, 83 BANKERS MAG. 301, 301 (1911).

n44. Dick Miller, Blue Sky Law, 77 AM. BANKER 3769, 3770 (1912).

n45. Banking and Mining Shares, supra note 26, at 1337.

n46. Get-Rich-Quick Advertising, 82 BANKERS MAG. 564, 564 (1911).

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[*358] One thoughtful article from 1911 analyzed the "astonishing phenomenon" among the "plain working-people" who had suddenly changed from "practising for years the most stringent economy and careful saving to taking risks that involve their entire future welfare." n47 These individuals, said the writer, "may previously even have been suspicious of the advice of individuals whose integrity they knew well" -- an implicit reference to the local banker -- "yet they will listen to a stranger who offers them something that is, without doubt, plausibly presented but which violates all their previous prejudices and should be judged and condemned by their common sense." n48 Presumably the common working person was susceptible to these promotions both because of greed -- "their spoken and written prospectuses . . . emphasize the great profits to be made within a few years without effort and for only a small investment" n49 -- and overstimulated imagination -- "[t]o a man who has lived all his life in a little town where nothing ever happened but the 'up' train in the morning and the 'down' train at night," n50 the "wonderful inventions" n51 and "great activit[ies]" n52 touted in the promoters' "glittering manifestoes" n53 was irresistible.

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n47. Holden, supra note 32, at 188.

n48. Id.

n49. Id.

n50. Id. at 189.

n51. Id.

n52. Id. at 188.

n53. Id. at 191.

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Bankers were also stunned and threatened by the power of the uninhibited marketing techniques used by securities promoters. An editorial in Bankers Magazine, displaying perhaps a smidgeon of publisher's self-interest, warned that the promoters of "get-rich-quick" schemes were "successful[ly] bidd[ing] for the people's money" by the use of effective advertising and suggested that false ideas of decorum should not deter banks from "talk[ing] face to face with those whose money [promoters were] expected to get." n54 Also expressing interest in helping the banks develop effective promotional practices of their own was a group of advertising men formed in 1913, the Bank Publicity Association of New York, which stated one of its goals to be "the elimination of fraudulent and [*359] misleading financial advertising." n55 Getting to the root of the matter, the advertising men observed that "[d]eposits are often withdrawn from banks to be utterly lost in foolish ventures, which have been called to the attention of the public by advertisements, and money is thus taken out of the legitimate channels of investment." n56

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n54. Weeding Out the "Get-Rich-Quick["] Concerns, 82 BANKERS MAG. 162, 162 (1911). The reference was to an unwritten rule of bankers' ethics which prohibited advertising. See supra note 35. Bankers were quick to accept the invitation to advertise. By 1913 savings banks were touting their four percent interest as being "ABSOLUTELY SAFE" and "an exceedingly generous interest rate" and complimenting their depositors for possessing "sturdy common sense and a STEADINESS quite unknown to some of our more venturesome 'financiers.'" T.D. MacGregor, Out-of-the-Ordinary Advertising, A Los Angeles Bank that Uses Big Space and Does Not Waste It, 86 BANKERS MAG. 459, 461 (1913) (emphasis in original).

n55. See Bank Publicity Association of New York, 87 BANKERS MAG. 50, 52 (1913) (quoting a June 17, 1913 speech by the association's president, E.B. Wilson).

n56. Id. In addition to promoting their own product, the banking industry sought to retaliate by denigrating the competition. In 1913 the Savings Bank Section of the American Bankers Association distributed a press release on the "get-rich-quick" folly, painting a grim picture of fraudulent securities promotions, to newspapers across the country. Talks on Thrift, supra note 39, at 180-81. The savings bankers encouraged newspapers to editorialize:

We sincerely believe that for a small sum there is no better investment in the country than a savings bank account and that no one makes a mistake in leaving his surplus money there until he has better use for it. Stick to your savings account until you have accumulated something worth while [sic] to invest. Then consult somebody you can depend upon in regard to its permanent investment. . . . When you have saved sufficient money to make an investment worth while [sic], consult a banker or newspaper in your community, and above all things, DON'T BE A SUCKER!

Id. at 181 (emphasis in original). The author of this article suggested that some "missionary work" might be necessary to induce the editor to use the press release for free and recommended that the editor be informed "that the savings bank men have no personal axe to grind in this matter and that publishing the articles will help the newspaper to get and hold more paid bank advertising." Id.

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In addition to banks, reputable securities houses also objected to the sudden popularity of speculative securities. In the view of one dealer who attempted to organize a national association of bond dealers in 1911, issues of worthless securities had limited or blocked the sale of good bonds that could readily be marketed under proper conditions. n57 According to this dealer, a national association would distinguish good bonds from bad and prohibit any of its members from dealing in dubious securities, thus lifting the "imaginary cloud of distrust" which at times enveloped the bond market. n58

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n57. National Bond Dealers' Association, 76 AM. BANKER 1941, 1941 (1911).

n58. Id.

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III. The Kansas Blue Sky Laws of 1911

Against this backdrop of public and private antagonism to securities speculation emerged the state blue sky laws. n59 By all accounts the [*360] inventor of blue sky legislation was the Kansas Commissioner of Banking, a regulatory entrepreneur by the name of J.N. Dolley of Maple Hill, Kansas. n60 In addition to running a vigorous, reputable, and well-funded banking department, n61 Dolley was a retired "grocery man" and either a [*361] director or the president of a local bank. n62 A man of considerable promotional talents, he advanced the idea of blue sky regulation in a series of newspaper articles in 1910, n63 complaining that Kansas widows were being fleeced by fraudulent securities salesmen and voicing an intent to seek legislation to "remove these financial cancers entirely from our State." n64

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n59. The derivation of the term "blue sky law" is a matter of considerable uncertainty. The most plausible explanation in the literature, advanced by a careful and informed student of blue sky laws, is that the term referred to the fact that the fly-by-night operators in Kansas operated so blatantly that they would "sell building lots in the blue sky in fee simple." Thomas Mulvey, Blue Sky Law, 36 CAN. L. TIMES 37, 37 (1916). The author supplies no authority for this etymology, however. An earlier explanation, offered by a prominent investment banker and opponent of blue sky laws, is that the term referred to the idea that the "maker of bad paper might just as well be capitalizing the blue sky and selling shares therein." Warren S. Hayden, Blue Sky Laws and Their Relations to the Investment Banker, in PROC. OF THE ORGANIZATION MEETING AND OF THE FIRST ANN. CONVENTION OF THE INVESTMENT BANKERS' ASS'N AM. 139, 139 (1912) [hereinafter 1912 IBA PROCEEDINGS]. This sounds too much like the argot of the investment banker to be credible as an account of a phrase widely circulating in popular culture. Another author explained that "[w]e may say the promoter of these [speculative] corporations capitalizes an idea of business, rather than the substance, and therefore, gives . . . in the form of certificates of stock nothing more than the blue sky, and many times it is not as good as our October sky." Miller, supra note 44, at 3770.

Our own investigation of the primary sources has not succeeded in clarifying the matter. The earliest use of the term "blue sky" we have discovered is from 1910 in a press release issued by Kansas Banking Commissioner J. N. Dolley (whose activities in promoting blue sky legislation are discussed at length in this Article), which complained about the "enormous amount of money the Kansas people are being swindled out of by these fakers and 'blue-sky merchants.'" Letter from J. N. Dolley (Dec. 16, 1910), reprinted in Brief for Appellees at 33, Merrick v. N. W. Halsey & Co., 242 U.S. 568 (1917) (No. 413) [hereinafter Dolley Letter]. Dolley here appears to refer to a term already extant in the culture, as he offers no explanation for the unusual terminology. The phrase had unquestionably come into common parlance by 1912. An editorial in Bankers Magazine referred to the "so-called 'blue sky' laws" with the assumption that the reference was already well known. See The "Blue Sky" Laws, 84 BANKERS MAG. 635 (1912). Others made reference to "blue-sky and other fake promotion schemes," John R. Lindburg, Kansas Bankers' Association Convention President's Address, 77 AM. BANKER 1883, 1883 (1912), and the laws adopted in response as "ant[i]-blue-sky scheme[s]," Geo. W. Martin, A Chapter from the Archives, 77 AM. BANKER 1884, 1888 (1912). By 1914 the origin of the term was forgotten: a comment in Bankers Magazine observed that "[b]y some accident of fate the nomenclature of 'Blue Sky Laws' has been given such endeavors." "Blue-Sky" Legislation, 88 BANKERS MAG. 460, 460 (1914).

Our view -- itself highly speculative -- is that the phrase could not have been newly minted in 1910 without some explanation appearing in the historical record. Since the term evidently came out of Kansas, it seems most likely that it had long been in use there to describe some other type of fraudulent conduct outside the securities area, most likely fraudulent land promotions during pioneer days, and was simply borrowed for the context of securities fraud laws.

n60. See Mark A. Sargent, State Disclosure Regulation and the Allocation of Regulatory Responsibilities, 46 MD. L. REV. 1027, 1040 n.67 (1987) (calling Dolley "the first blue sky commissioner"); see also Martin, supra note 59, at 1888 (referring to "Dolley's ant[i]-blue-sky scheme"); Alexander H. Robbins, The Kansas "Blue Sky Law," 75 CENT. L.J. 221, 221 (1912) (noting that Dolley is an "authoritative and accurate" source on blue sky laws). Dolley had been appointed bank commissioner in 1910 by Kansas Governor Walter R. Stubbs, a Republican and an admirer of Theodore Roosevelt. CAROSSO, supra note 7, at 163.

Rhode Island had adopted a statute in 1910 that required certain issuers to file statements of condition with the Secretary of State before selling securities in that state. Act of July 1, 1910, ch. 557, 1910 R.I. ACTS & RESOLVES 61. A few years earlier California and a few other states adopted legislation that imposed criminal penalties on persons who knowingly misrepresented a corporation's financial affairs. See "Blue Sky" Bill: Hearings on H.R. 10102 Before the House Comm. on Interstate and Foreign Commerce, 67th Cong., 2d Sess. 111 (1922) (statement of James Callbreath) [hereinafter Blue Sky Hearings]. We do not treat these earlier state ventures into securities regulation as "blue sky" bills because they had no general influence on the subsequent development of state securities regulation.

n61. The state of Kansas was generous to Dolley and his department; his budget of approximately $ 35,000 exceeded those of banking departments in all but ten states. See ANNUAL REPORT OF THE COMPTROLLER OF THE CURRENCY 220-21 (1911) [hereinafter 1911 REPORT]. At the same time as he was drafting blue sky legislation, Dolley was working actively to improve bank profits by

restricting the number of banks. Dolley gained national publicity when he refused several charter applications in 1911, professing that "one of the greatest evils and most dangerous conditions in the banking world to-day [sic] is the indiscriminate granting of bank charters. . . . In the past, charters have been granted indiscriminately to whoever might make application for them, regardless of the public's interest. . . . The proper organization of a bank in the first instance is more than half responsible for its ultimate success." Too Many Banks, 83 BANKERS MAG. 413, 413 (1911). Dolley also instituted a rigorous examination requirement for bank presidents and cashiers. See J. N. Dolley, Educating the Banker and Keeping a Watch on Him, 85 BANKERS MAG. 494, 494 (1912).

n62. Thomas Mulvey has Dolley as a bank director, Mulvey, supra note 59, at 37, while IBA General Counsel Robert R. Reed makes him out to be the president of a local savings bank. Reed, supra note 7, at 178. It should be noted that Reed was the principal lobbyist for the Investment Bankers Association, the leading group in opposition to the blue sky laws, and the accuracy of his account may therefore be somewhat doubtful on this point. See id. at 177 n.1 ("Mr. Reed has been intimately connected with the development of 'Blue Sky' legislation both individually and as counsel for the Investment Bankers Association of America.").

n63. See Reed, supra note 7, at 178.

n64. Dolley Letter, supra note 59, at 34.

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Dolley successfully lobbied the Kansas legislature in 1911 for passage of his proposal. n65 The Kansas law n66 generally required that firms selling securities in Kansas obtain a license from the bank commissioner and file regular reports of financial condition. n67 Investment companies were also required to file reports of their business plan and financial condition and to file a copy of all securities they proposed to sell in Kansas. n68 The bank commissioner was authorized to bar an investment company from the state if he concluded, upon examining these documents, that the information about the investment company or security proposed to be sold contained any "unfair, unjust, inequitable or oppressive" provision, n69 or that the investment company was "not solvent and d[id] not intend to do a fair and honest business, and . . . d[id] not promise a fair return on the stocks, bonds or other securities . . . offered for sale." n70 The bank commissioner was also authorized to conduct examinations of investment companies and to seek appointment of a receiver to wind up the affairs of any investment company found to be insolvent or to be run in an "unsafe, inequitable, or unauthorized manner." n71 State and national banks, trust companies, building and loan associations, real estate mortgage companies, and nonprofit corporations were exempted from the requirements of this [*362] statute. n72 The statute also exempted a few classes of securities: federal, state, and municipal bonds and notes secured by mortgages on Kansas real estate. n73

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n65. See J. N. Dolley, Blue Sky Law, 77 AM. BANKER 1705, 1706 (1912).

n66. Act of March 10, 1911, ch. 133, 1911 Kan. Sess. Laws 210.

n67. Id. @@ 6-8.

n68. Id. @ 2.

n69. Id. @ 5.

n70. Id.

n71. Id. @ 11.

n72. Id. @ 1.

n73. Id.

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We have not uncovered direct evidence as to whether this legislation was solely the result of Dolley's personal efforts in mobilizing the generalized public resentment against securities frauds, or whether Dolley enjoyed the backing of any organized interests in his campaign. There is good reason to believe, however, that the legislation enjoyed the approval, if not the active support, of state-chartered banks in Kansas. Dolley, as we have noted, was a banker himself as well as the state banking commissioner. He would have been able to exercise considerable leverage on the banks under his supervision to support the proposed legislation. And the legislation itself served the interests of Kansas bankers. It protected the secondary market in mortgage notes by exempting these securities from regulation, thus propping up the value of assets that represented a significant part of state bank portfolios. It protected banks from competition in the securities business by regulating the activities of nonbank securities firms while exempting banks from these regulations. Most importantly, it reduced the danger that depositors would withdraw their funds from banks and invest them in higher yielding securities.

This last concern was particularly important in 1911, when Kansas enacted a statute which, at the behest of state banks, authorized the banking commissioner to cap deposit interest rates. n74 To the delight of the Kansas State Bankers' Association, n75 Dolley limited all state banks to a maximum interest rate on time deposits of three percent, explaining that the rate was necessary to "protect the State banks . . . from ruinous competition." n76 With rates capped at three percent, state banks were hard pressed to compete on the basis of a promised return even with conservative industrial bonds which were paying around five percent at the time n77 -- much less with speculative securities which, while presenting greater risk, also promised large profits if the enterprise in question proved successful. [*363] Total deposits in state-chartered banks in Kansas dropped off in 1911, falling from $ 96,254,685 in March to $ 92,755,922 in June. n78 Not surprisingly, Kansas bankers were enthusiastic about the new blue sky law. The President of the Kansas Bankers' Association marveled that Dolley had "become a terror to all blue-sky and other fake promotion schemes." n79 The only question raised about the new statute at the Kansas Bankers' Association Convention in 1912 was whether "Dolley's ant[i]-blue-sky scheme could . . . be extended" even more. n80

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n74. Act of Feb. 27, 1911, ch. 61, 1911 Kan. Sess. Laws 61; see also New Banking Law for Kansas, 76 AM. BANKER 918, 918-19 (1911) (noting with approval the enactment of the Kansas statute).

n75. See Topeka, Kan., 76 AM. BANKER 1110, 1110 (1911) ("The executive committee of the Kansas State Bankers' Association . . . endorsed the action of Mr. Dolley in n connection with the rates of interests permissible to be paid upon time deposit.").

n76. New Banking Law for Kansas, supra note 74, at 919. The commissioner retained the power to allow higher rates on a county-by-county basis if national banks in the area started paying higher rates. Id.

n77. Industrial bond quotations are contained in the volumes of American Banker for the years in question. Most high-grade industrial bonds paid about 5% in 1911. See, e.g., Kansas City, Mo. Securities, 76 AM. BANKER 990, 990-91 (1911) (chart).

n78. Banks of Kansas, 76 AM. BANKER 2573, 2573 (1911). J.N. Dolley issued a statement with this report attributing the decrease in deposits to the use of money to plant and harvest crops, id., but disintermediation seems the more likely explanation.

n79. Lindburg, supra note 59, at 1883.

n80. Martin, supra note 59, at 1888.

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Dolley immediately began to enforce the Kansas statute with the energy befitting its creator. Before the statute was enacted, in Dolley's estimation, Kansans were investing as much as six million dollars a year in worthless securities. n81 Not so after the blue sky law. By May 1912 Dolley reported that of approximately eight hundred applications for permission to do business in Kansas under the law, he had approved only about seventy. n82 By September he announced that he had investigated between fourteen and fifteen hundred companies since the enactment of the law and granted permits to less than one hundred. n83 Dolley disclosed that about half the applications were from mining, oil, or gas stocks and intimated that all of these had been rejected: "I believe I am safe in saying that where there has been one dollar invested in mining, oil and gas stocks there has been ninety-eight cents lost." n84 Most companies, said Dolley, "never got further than making the application. . . . •As soon as they found out what information we were going to ask them for and what the nature of our investigation was going to be, they suddenly changed their minds and withdrew their applications." n85 According to Dolley, at least, enforcement of the law had other dramatic effects as well. The stiff penalties and fines threatened under the Kansas legislation caused as many as fifteen hundred "crooks," "confidence men," and "undesirables" to flee the state. n86

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n81. See Dolley, supra note 65, at 1705.

n82. Id.

n83. Mulvey, supra note 59, at 38.

n84. Dolley, supra note 65, at 1705.

n85. Id.

n86. Promotion Schemes in Texas, 77 AM. BANKER 1386, 1386 (1912).

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Ironically, in light of Dolley's insistence on honesty in securities dealings, many of his claims about the scope and success of the Kansas law were subsequently found to have been grossly overstated. Thomas Mulvey conducted a personal investigation of the files of the Kansas Bank [*364] Commissioner's office and found that Dolley's claims about the number of companies refused permission to do business in the state were unsupported, as were his boasts about the ability of the Kansas law to prevent fraud. n87 Mulvey found that through April 1, 1913 -- three years into the operation of the statute -- permits had been granted to forty-nine companies and refused to only sixty-two. n88 Dolley had also issued a number of temporary permits on his personal authority, without statutory authorization; the result was that "serious frauds" were committed. n89 Mulvey found "no basis whatever" for Dolley's claims that he had saved as much as six million dollars for the people of Kansas: "[t]here were no statistics or other evidence in the office of the Bank Commissioner in May, 1913, upon which such a statement could be founded." n90

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n87. Mulvey, supra note 59, at 39.

n88. Id.

n89. Id.

n90. Id.

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IV. Political Support and Opposition: 1912-1913

Regardless of its actual impact, the apparently unprecedented nature of the Kansas law, coupled with Dolley's penchant for publicity n91 -- which rivalled that of the blue sky operatives themselves -- sparked great interest in the statute. Dolley received requests for copies of the new law from nearly every state in the union and bragged that "all the leading magazines of the world had written about the measure." n92 The governments of England, Germany, and Canada requested copies. n93

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n91. See CAROSSO, supra note 7, at 189 (observing that "[f]ew laws were so well advertised").

n92. Dolley, supra note 65, at 1706.

n93. Id.

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Not coincidentally, various political interest groups also began to organize both for and against blue sky legislation in the immediate aftermath of the Kansas statute. Those favoring blue sky legislation on the Kansas model were small banks, state bank regulators, and businesses and farms which relied on bank financing. n94 Opposing the Kansas law -- although not necessarily hostile to other types of regulation -- were the elite investment bankers, large industries which enjoyed access to securities markets for financing, and, to a lesser extent, larger banks which were active in the securities business at the time. n95

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n94. See infra notes 106-19 and accompanying text (discussing support for blue sky legislation from the smaller banks and state regulators); infra notes 120-27 and accompanying text (discussing support for blue sky legislation from farmers and businesses reliant upon bank credit).

n95. See infra notes 140-49 and accompanying text (discussing the efforts of investment bankers to distinguish themselves from less reputable competitors while simultaneously fighting Kansas-style blue sky legislation); infra notes 150-55 and accompanying text (describing opposition to blue sky laws among bond issuers); infra text accompanying notes 155-75 (outlining the different agendas of the big, money-center banks and their smaller counterparts); infra notes 176-79 and accompanying text (recounting big bank opposition to blue sky laws).

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[*365] A. Interests Favoring Blue Sky Legislation 1912-1913

1. Smaller Banks and State Bank Regulators. -- Perhaps the most important group favoring blue sky legislation on the Kansas model were smaller banks and state bank regulators. Encouraging these interests was the effervescent J. N. Dolley, who embarked on a nationwide campaign for blue sky legislation in 1912 after his victory in Kansas the previous year. He spoke at Oklahoma n96 and Tennessee n97 bankers' conventions, corresponded with his fellow state bank commissioners, n98 and trumpeted the virtues of his scheme in press releases to national banking journals. n99

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n96. Dolley, supra note 65, at 1705.

n97. Program for Tennessee Bankers' Convention, 77 AM. BANKER 1523 (1912).

n98. Promotion Schemes in Texas, supra note 86, at 1386.

n99. Topeka, Kan., supra note 75, at 1574.

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As Dolley was quick to point out, the great benefit that blue sky legislation afforded to small banks was that it stifled competition for the funds of potential depositors. "There is nothing which the banker dislikes so much," he told Oklahoma bankers, "as to see one of his customers withdrawing some of his money for the purpose of investing it in some sort of an investment which the banker knows is questionable and from which the banker knows he will get no returns." n100 That is why, Dolley continued, "bankers should be interested in legislation of this character and why you should lend all the aid and assitance you can towards securing such legislation and towards its enforcement, after it has been secured." n101

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n100. Dolley, supra note 65, at 1705.

n101. Id.

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Dolley backed up his warnings about lost deposits with glowing accounts of the benefits of the Kansas law. Of the millions of dollars in fraudulent securities once sold in Kansas, he remarked, "98 [percent] of it was either borrowed from the banker or taken from his deposits." n102 Not so after the blue sky law. Dolley issued a press release to The American Banker boasting that deposits in Kansas state banks had increased dramatically due to the exodus of "blue sky speculators." n103

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n102. Id. The fact that the money used to buy these securities might have been borrowed from bankers would not have suggested that bankers benefitted from speculative securities. In Dolley's portrayal, at least, all the money borrowed was lost, so the borrower would not be a good customer of the bank and would be very likely to default.

n103. See Topeka, Kan., supra note 75, at 1574.

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Dolley cleverly used his own success in driving out the blue sky operators as a lever to encourage other states to do the same. He painted a vivid picture of armies of grifters, confidence men, and bunco artists descending like locusts on other states. He warned the Texas Bank Commissioner that his own success in evicting the miscreants "probably [*366] has been unfortunate for our sister States," and expressed little doubt "that Texas will get her share of these grafters." n104 The Texas Banking Commissioner quoted this correspondence in an article in the Texas Bankers Record, alerting Texas bankers that "because other States are adopting laws to control the sale of stocks, . . . these sharks are coming in droves to those States, like Texas, which have no laws controlling stock selling." n105

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n104. Promotion Schemes in Texas, supra note 86, at 1386.

n105. B. L. Gill, Promotion Schemes, TEX. BANKERS REC., Apr. 1912, at 4.

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Small bankers and state bank regulators enthusiastically supported blue sky legislation in 1912 and 1913. Leaders of state bankers' associations were thoroughly briefed on the merits of the Kansas statute at a meeting in Chicago early in 1912. n106 State bankers' associations circulated copies of the Kansas statute to their members. n107 Blue sky legislation was a leading theme at the convention of the National Association of State Bank Superintendents in 1913. n108 The President of the Florida Bankers' Association recommended a blue sky statute for his state to control the sale of "securities that are steeped in fraud." n109 The President of the Illinois Bankers' Association wrote to bankers throughout his state advocating the "desirability of adopting in Illinois some such legislation as the 'blue sky' law enacted in Kansas." n110 Calling on Texas bankers to lobby for "a bill to control and stop this legal robbery" (i.e., questionable securities sales), the Texas banking commissioner predicted that "powerful lobbies" would arise to fight such legislation, but that they would be shown "no more consideration than the commonest crook." n111 A speaker at the Texas Banking Convention railed against the "conscienceless robberies" of the "Blue Sky" salesmen and called on the bankers of the state to "rise as one man and fight this practice." n112 Indiana bankers heard a jeremiad against the "financial parasites" who "preyed upon the investing public, your depositor." n113 The Executive Committee of the Washington Bankers' Association endorsed the Kansas law and called for its passage as modified to account for conditions in that state. n114 The vice president of a national [*367] bank sponsored blue sky legislation in Oregon. n115 The President of the North Dakota State Bankers' Association told his state's convention that "[w]e all know the evils of unlimited freedom of stock-jobbing, . . . and our legislative committee would do well in trying to get [a Kansas-style] law grafted into our statute." n116 The President of the Colorado Bankers' Association approved the general thrust of the Kansas statute, although he cautioned that the Kansas law vested too much power in the bank commissioner. n117 The Secretary-Treasurer of the Alabama Bankers' Association cautioned that

[t]he people of Alabama have been literally robbed of thousands of dollars by pure fake and near fake enterprises. The Legislature should protect the public from this shameless stock jobbing. I believe if the association stood for the 'Blue Sky Law of Kansas' it would meet with the approval of all honest people. n118

The Alabama Superintendent of Banking heartily concurred, observing that "[m]uch money is annually withdrawn from banks for these fraudulent schemes" and promising, if given the enforcement responsibility, to "drive these swindlers out of your borders, as Mr. Doll[e]y, of Kansas, has driven them out of his State." n119

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n106. See Karl J. Farup, North Dakota State Bankers' Association Convention, 77 AM. BANKER 2659, 2659 (1912) (reporting a meeting of state bankers' association secretaries in Chicago at which "the Blue Sky Law of Kansas . . . was thoroughly explained to us").

n107. See, e.g., Miller, supra note 44, at 3771 (noting that attendees of the Indiana convention had received copies of the Kansas statute "[b]y the courtesy of [their] organization").

n108. See Minneapolis and St. Paul, 78 AM. BANKER 1924 (1913).

n109. George W. Allen, Florida Banking Resources Increase, 78 AM. BANKER 1322 (1913).

n110. Chicago, Ill., 77 AM. BANKER 658, 658-59 (1912) (statement of B.F. Harris).

n111. Gill, supra note 105, at 4.

n112. C.A. Sanford, Conscience in Banking, 77 AM. BANKER 1610, 1611 (1912).

n113. Miller, supra note 44, at 3770.

n114. See P.C. Kaufman, Washington Bankers' Association Convention, 77 AM. BANKER 2498, 2500 (1912).

n115. See Portland, Oreg., 78 AM. BANKER 708, 708 (1913) (discussing the proposal of John A. Keating, vice president of Lumbermen's National Bank).

n116. Farup, supra note 106, at 2659.

n117. See Frank N. Briggs, Banking Conditions in Colorado, 77 AM. BANKER 2905, 2906 (1912).

n118. McLane Tilton, Jr., Alabama Bankers' Association Convention, 77 AM. BANKER 1714, 1716 (1912).

n119. A.E. Walker, The First Year Under the New Banking Law, 77 AM. BANKER 1719, 1720 (1912).

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2. Farmers and Smaller Businesses. -- In addition to small bankers and state bank regulators, nonbank business elements supported blue sky legislation as a means of enhancing their access to credit by excluding competition from out-of-state borrowers. Farmers, with their need for mortgage financing as well as for temporary credit between planting and harvest, were an obvious beneficiary. It is, accordingly, probably no accident that Kansas, a farming state, was the first to adopt blue sky legislation. Further, many of the strictest blue sky statutes were adopted by states with the greatest reliance on agriculture. n120

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n120. See infra notes 180-91 and accompanying text (chronicling the passage of blue sky laws in Kansas and other predominantly agricultural states in 1911, 1912, and 1913).

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But the potential support for blue sky legislation was by no means limited to farmers. For similar reasons, local industries of all sorts were also potential beneficiaries. Local chambers of commerce, which at the time were only beginning to come into their own as a political and social [*368] force, n121 were among the leading interests pressing for blue sky legislation in Ohio n122 and Oregon. n123 The National Citizens' League, an umbrella organization dedicated to enhancing the supply of credit to smaller businesses, n124 also seems to have endorsed the concept of blue sky merit regulation. The Chairman of its Executive Committee, addressing Alabama bankers in 1912, proclaimed that the "duty of the hour is to protect normal business from the sharks, whether in New York or across the Mississippi." n125 He went on to note that "[t]here is a tendency of commercial capital to move into the hands of promoters; therefore, abolish it by discriminating against investment securities [in favor of] loans by commercial banks." n126

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n121. During the early part of the twentieth century these chambers of commerce became much more active than before, with nearly six thousand organizations nationwide, ranging from small groups to large organizations with thousands of members such as the Chicago Association of Commerce and the Boston Chamber of Commerce. American Commercial Bodies, 77 AM. BANKER 727, 727 (1912). Chambers of commerce were not, however, organized in national or even regional organizations at the time. See id. Attempts were made to organize a national board of trade in 1912, see A National Board of Trade, 77 AM. BANKER 729 (1912), resulting in the establishment of the United States Chamber of Commerce in that year. See Robert F. Maddox, The Banker in Politics, 81 AM. BANKER 1690, 1690 (1916) (noting that before the creation of the United States Chamber of Commerce there had been "no organization in the United States where the businessmen of the country could meet on common ground at the Capitol of our country").

n122. See Hayden, supra note 59, at 140 ("[O]ne of the most influential chambers of commerce in the state [of Ohio] has had a definite intention for several months to see to it that a blue sky bill is introduced at Columbus this coming winter.").

n123. See Portland, Oreg., supra note 115, at 2648 (observing that the Portland Chamber of Commerce and Portland Realty Board lobbied for the proposed blue sky law).

n124. The National Citizens' League promoted currency reform to encourage bank investment in commercial paper, thus channelling funds to local businesses and away from Wall Street. See J. Laurence Laughlin, The Money Trust and Banking Reform, 77 AM. BANKER 1722 (1912).

n125. Id. at 1723.

n126. Id.

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Supporters of blue sky legislation were quite explicit about their wish to direct capital to local borrowers rather than see it drained out of state. A speaker at the Kansas bankers association convention in 1912 observed that

it is unfortunate that Commissioner Dolley's ant[i]-blue-sky scheme could not be extended to protect our own people who have invested . . . against the swamps of Florida, and the mesquite, cactus, sage brush, Alkali and orange ranches of the Southwest. . . . But Mr. Dolley is not omnipresent nor is he the personal guardian of each individual, and so gossip about a month ago had much to say about $ 28,000 leaving Topeka and going into a hole as certain as the descent of the Titanic. Untold thousands have gone out of Kansas in this way -- how can we stop the waste? n127

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n127. Martin, supra note 59, at 1888.

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[*369] Dolley himself frankly acknowledged that one purpose of the statute was to keep credit from being taken out of Kansas. He observed proudly that before the blue sky law went into effect millions of dollars a year were being "taken from Kansas." n128 This money, said Dolley, "was being taken by the promoter from our State to the headquarters of his company, a large [percent] of it going to New York and the East." n129 The Kansas statute, said Dolley, had changed all that. Of the seventy applications to sell securities in Kansas which Dolley had granted under the new law, "the greater majority . . . have been for Kansas industrial and home enterprises." n130 Dolley went on to boast that he had put a stop to one out-of-state company that had been selling securities in the state at a rate of $ 300,000 per month, thus saving millions of dollars for the "widows, orphans and the poorer class of people, who form the investing public." n131 Later he issued a press release commenting on the effects of the Kansas law and observing, in words that must have pleased local borrowers, that

[t]here is an unlimited field for investment in Kansas to develop Kansas and such investments will bring a fair rate of interest and a more sure investment can not be placed in the investment world. Keep Kansas money in Kansas to develop the unlimited resources of the greatest State in the American Union should be the watch-word. n132

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n128. Dolley, supra note 65, at 1705.

n129. Id.

n130. Id.

n131. Id. at 1706.

n132. Topeka, Kan., supra note 75, at 1574.

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Kansans were not alone in emphasizing the importance of keeping credit in-state. The President of the bankers' association in Louisiana -- one of the first states after Kansas to adopt blue sky regulation -- told his group that "the sooner we learn the lesson of keeping our money at home and patronizing

home industry," instead of putting it into the hands of the "New York Stock Exchange speculators and gamblers," the "better it will be for our State and the South." n133 The President of the Tennessee Bankers' Association echoed these sentiments, observing that

[i]t is a mistake on the part of the citizens of this State to invest their surplus elsewhere which should be used in developing properties at home. The facilities for all to trade in the Stock Exchange have been so extended that any one with a few dollars to invest is tempted to try his luck in a share of stock in some large or small corporation [*370] concerning which he knows practically nothing rather than invest his money in some local enterprise . . . n134

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n133. Joseph Gottlieb, Louisiana Bankers' Association Convention, 7 77 AM. BANKER 1431, 1443 (1912).

n134. Wesley Drane, Address of the President, 77 AM. BANKER 1988, 1988 (1912).

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The parochial purpose of many blue sky laws was well understood by knowledgeable observers in later years. Congressman Edward Denison of Illinois observed in 1923 that

[t]here are unfortunately those in legislative positions in some States who do not take a broad view of this subject; they would prefer that outside securities be not allowed to come into their State to absorb the capital of their own citizens, because they want their citizens to invest their money in their own developments and enterprises. This is not a mere imaginary case. I have been informed that some State [blue sky] laws have been administered with that end in view. n135

A representative of the elite investment bankers concurred in 1922, quoting a state securities commissioner as saying, "I have not approved any more securities in my State in the last few months that I could help. Money is mighty scarce down there and I don't propose to let any of our money get out in the securities of corporations of other States." n136

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n135. Regulating the Sale of Securities: Hearings on H.R. 10598 Before a Subcomm. of the Senate Comm. on Interstate Commerce, 67th Cong., 4th Sess. 9 (1923) (statement of Rep. Denison) [hereinafter Regulating the Sale of Securities].

n136. Blue Sky Hearings, supra note 60, at 54 (statement of George W. Hodges).

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B. Opponents of Blue Sky Legislation

1. Elite Investment Bankers. -- The principal opponents of blue sky legislation were the elite investment bankers who broke away from the American Bankers Association in 1912 and established their own organization, the Investment Bankers Association (IBA). n137 The IBA's members came from a variety of states, but most were headquartered in New York, Illinois, Pennsylvania, Massachusetts, and Maryland. n138

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n137. See 1912 IBA PROCEEDINGS, supra note 59, at 5 ("This gathering [gives] to the public its first assurance of an association, constituted purely of investment bankers, organized primarily to improve the standard of those engaged in investment banking and for the general protection of the investing public."); CAROSSO, supra note 7, at 165-70 (describing the formation of the IBA in "response to mounting public criticism and increasing demands for regulatory legislation"). Members of this association appear to have been engaged almost exclusively in the distribution of corporate bonds, as there is little if any reference to equity securities during the early meetings.

n138. As of 1913, the IBA included 110 New York firms, 81 Chicago firms, 39, Philadelphia firms, 26 Boston firms, and 21 Baltimore firms. INVESTMENT BANKERS ASSOCIATION, PROCEEDINGS OF THE ANNUAL CONVENTION 287 (1913) [hereinafter 1913 IBA PROCEEDINGS] (Membership List). Very few IBA members were located in states adopting blue sky legislation in 1912 or 1913. Id.

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An important part of the IBA's agenda was to distinguish themselves from the "fly-by-night operators" and the "get-rich-quick" artists who were casting the entire securities industry in a bad light. n139 Although the IBA [*371] members did not say so, many of the firms distributing such "doubtful" securities were also new entrants into the securities business who represented potential competition for the elite firms in the IBA. Thus to the extent that the blue sky laws were actually used to stamp out the marginal operators, the IBA had a common interest with the small bankers and their regulators.

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n139. In the view of one early proponent of a bond dealers association:

Only swindlers profit by floating worthless securities, and reliable houses have no desire to share in this kind of profit. With the weeding out of the unreliable concerns and the black-listing of dubious issues, the legitimate concerns in the bond business would obtain such an expansion of their field of operation that the result would be a golden harvest of new business.

National Bond Dealers' Association, supra note 57, at 1941.

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Although the IBA wanted to extinguish the purveyors of speculative securities, it did not favor doing so by means of blue sky legislation on the Kansas model. n140 Blue sky legislation imposed greatly increased administrative burdens on securities distribution and was likely to be administered in favor of local interests and to the detriment of the Wall Street or LaSalle Street

firms. The IBA's members understood, moreover, that on the blue sky issue their interests were opposed to those of smaller banks that supported such legislation. One investment banker characterized the blue sky legislation in 1912 as follows: "Taking into account the exceptions made by the law, it says in effect, that anybody but a bank must satisfy the Commissioner if he wants to sell private corporation bonds." n141 This speaker warned deposit bankers "not to think that [they] can gain advantage by getting back of legislation of this kind upon the theory that the banks would acquire the bond business of the country." n142

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n140. See, e.g., Chicago, Ill., 78 AM. BANKER 1506, 1507 (1913) (describing the IBA's distribution of a seventy-five page comprehensive survey of every state's blue sky legislation); Investment Bankers Meet in St. Louis, 78 AM. BANKER 1693, 1693 (1913) (claiming that while the IBA did not wish to suppress wise laws, it would oppose those laws which would "unnecessarily and unjustly hamper legitimate business"); Robert R. Reed, Annual Report of Counsel, 1913 IBA PROCEEDINGS, supra note 138, at 164, 166-67 (expressing the opinion that the Kansas blue sky law was unconstitutional).

n141. Hayden, supra note 59, at 142-44 (emphasis added).

n142. Id. at 144.

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Kansas-style blue sky legislation, according to the IBA's general counsel, did not represent a "fair and proper attack on irresponsible and fraudulent or so-called 'fly-by-night' schemes of stock flotation." n143 It was, rather, an "unwarranted" and "revolutionary" attack upon legitimate business. n144 The problem, according to one IBA member, was that the state legislatures had confused the functions of the investment banker with those of the "mere broker." n145 The mere broker "has no moral responsibility. He does not endorse, even in a moral way, the investments he may [*372] purchase for a customer. If loss is incurred, the broker is by no means to blame." n146 But the position of the investment banker was radically different:

His reputation and the reputation of his house is bound up in the securities he sells. . . . He must stand sponsor for those bond issues which his House handles alone and with which its name is indissolubly bound up. If these "specialties" are not listed in the stock exchange -- and the great majority of sound bond issues are not listed -- he must maintain a market for them for the accommodation of his clients. He must exercise supervision to make certain that the interests of his clients are protected, not only before the loan is sold, but after it is sold and throughout its life until its final maturity. n147

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n143. Reed, supra note 140, at 168.

n144. Id.

n145. See S.W. Straus, The Ethics of Investment Banking, 87 BANKERS MAG. 411, 412 (1913).

n146. Id.

n147. Id. at 413.

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In place of Kansas-style blue sky legislation, the IBA pushed its own model legislation that would have effectively distinguished between the functions of the investment banker and the mere broker. Significantly, the proposal lacked any provision for regulatory scrutiny of the merits of proposed securities offerings. The IBA's proposal required the registration of securities dealers and imposed a strengthened fraud remedy for misstatements in connection with the sale of securities. n148 The IBA did not offer its proposal as a model for federal regulation, even though federal regulation had obvious potential as a means of achieving uniformity of enforcement. n149

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n148. See Reed, supra note 140, at 164 ("The general plan of this proposed act provided for the registration of dealers, upon an investigation of their business character and repute and of the character of the securities in which they dealth."); Regulation of the Sale of Securities, 86 BANKERS MAG. 418, 418-19 (1913) (outlining the main purpose of the proposed act and questioning whether "the proposed measure would accomplish this laudable aim without injuring legitimate investment offerings").

n149. Bankers Magazine critized the proposal on this ground, observing, sensibly, that if new legislation were needed -- which the periodical doubted -- it should be federal in order to reduce hardship to legitimate securities issuers and to achieve uniformity. See Regulation of the Sale of Securities, supra note 148, at 419.

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2. Bond Issuers. -- Aligned with the IBA in opposing blue sky legislation were larger industries whose ability to obtain funds on capital markets was threatened by the blue sky phenomenon. These industries included manufacturing firms, railroads, and public utilities, all of which raised a significant amount of capital by bond issues in securities markets. n150 In the words of the counsel for the Michigan Bankers' Association, [*373] one of the few individuals associated with state banks to speak out against blue sky legislation between 1911 and 1913, the Michigan blue sky law "can and will stop the Michigan industry which should have immediate financing. It will tend to create foreign corporations and stop the issue of investment bonds and stocks on our Michigan industries. It will not hurt the broker but the manufacturer who needs new capital." n151

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n150. See MICHIE, supra note 22, at 222, 222-23 (providing data to support the assertion that, although "numerous enterprises . . . did not rely on the issue of securities to meet their capital requirements," by 1913 the "major undertakings in such areas of the economy as transportation, communications, urban utilities, banking, insurance, mining, manufacturing and distribution were financed by way of publicly held stocks and bonds").

n151. Hal H. Smith, Tendencies of Recent Banking Legislation in Michigan, 78 AM. BANKER 2297, 2298 (1913).

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The IBA enlisted the aid of these larger industries in the fight against blue sky laws. n152 In Indiana, a state with significant manufacturing interests but without major commercial or investment banks, the state legislature passed a blue sky bill in 1912. n153 The Indiana Manufacturers Association joined with the state's investment bankers to lobby against the legislation before the state's governor, who had endorsed the concept of blue sky legislation in his election campaign. Conveniently advised by his Attorney General that the measure was open to constitutional attack, the Governor vetoed the bill early in 1913, n154 observing that while the bill was "commendable in its attempt to annihilate the schemer or illegitimate dealer, its methods put too great a hardship upon legitimate business." n155

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n152. See Blue Sky Laws, 78 AM. BANKER 1158, 1159 (1913) (quoting George B. Caldwell, President of the IBA: "the average honest manufacturer, railroad operator, or public utility owner, or promoter of any legitimate enterprise, does not appreciate the undue hardships that would accrue to him were the average pending measure enacted into law").

n153. "Blue Sky" Legislation in Indiana, 78 AM. BANKER 921, 921 (1913).

n154. Id.

n155. Hearing on "Blue Sky" Bill, 78 AM. BANKER 1008, 1008 (1913).

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3. Bigger Banks. -- A final group opposing blue sky legislation was the nation's larger (or "money center") banks. The larger banks were located in urban areas and usually (although not always) operated under federal charter. Their interests, as they bore on blue sky regulation, thus differed significantly from those of smaller banking institutions which were typically (although not always) state-chartered institutions located in small towns or rural areas.

First, the larger commercial banks mostly served the needs of businesses and wealthy individuals. n156 These were not customers whose deposit business was likely to be lost to speculative securities promotions. And while these customers had ready access to securities markets, they had enjoyed such access for years. In contrast, the typical depositor in a small bank was exactly the type of person to whom the speculative securities [*374] were being marketed and who might be inclined to withdraw deposits and take a flier on a speculative security.

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n156. See CAROSSO, supra note 7, at 96 (stating that large, urban commercial institutions responded to early twentieth-century industrial and financial expansion by becoming "great banks" serving "[b]ig men" and "great

enterprises").

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Second, unlike the smaller banks, the larger commercial banks appear to have done well in 1911 and the preceding years. Average individual deposits per national bank increased from $ 672,000 to $ 753,000 between 1907 and 1911. n157 In contrast, average individual deposits per state-chartered bank decreased from $ 308,000 in 1907 to $ 215,000 in 1911, n158 while average individual deposits in savings banks decreased from $ 2,470,000 to $ 2,240,000. n159 Although some of these reductions reflected new chartering of start-up firms, the overall picture for the smaller depository institutions was not rosy as of 1911. Thus, the smaller banks had good reason to worry about further competition for deposits from any quarter, and the advent of a new competitor in the form of the securities industry was a particularly unwelcome development. The larger banks were not as threatened by the possible competition.

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n157. See 1911 REPORT, supra note 61, at 797.

n158. See id. at 798.

n159. See id. at 799.

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Third, national banks invested heavily in government bonds and other securities, owning an average of $ 242,000 in such securities in 1911. n160 The average state-chartered bank, by contrast, owned only $ 25,000 in bonds and other securities in 1911, n161 while the average stock savings banks owned an average of $ 107,000. n162 The only savings institutions exceeding national banks in terms of average bond investments were mutual savings banks, which -- evidently serving as precursors to today's mutual funds -- held an astounding average of $ 2,702,000 in bonds in 1911. n163

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n160. See id. at 37.

n161. See id. at 44.

n162. See id.

n163. See id. Mutual savings banks in general served a completely different class of customers and had different interests than stock savings banks during this period. Unfortunately, however, the data do not usually break out stock and mutual savings institutions. If the data did separate out these institutions, the characteristics of the stock savings banks would probably appear similar to those of state-chartered banks.

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Large bond holdings were unfavorable investments in times of high interest rates. As interest rates rose, bond portfolios fell in value, reducing the

banks' net worth. n164 National banks were thus hurt by their bond investments in inflationary times. On the other hand, national banks' bond portfolios gave them an interest in maintaining a ready market both for the purchase of new bonds and for the sale of old bonds from their vaults. In this respect, their large bond holdings gave them an interest in protecting [*375] securities markets against state interference under the blue sky laws. In addition, the biggest banks had also begun to value the securities markets for the liquidity which a market listing would give their own stock. n165

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n164. After hitting a low in 1908, interest rates crept steadily upward through 1911, causing a concomitant loss in long-term bond prices. For example, the United States bond maturing in 1925 fell from a high of 122 1/4% in 1908 to a low of 113 3/4% in 1911. See id. at 834-41.

n165. As of 1914 bank stocks with par value of $ 119 million were listed on the New York Stock Exchange. ANNUAL REPORT OF THE COMPTROLLER OF THE CURRENCY 106 (1914) [hereinafter 1914 REPORT].

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Fourth, aside from such bonds, national banks were overwhelmingly committed to commercial loans, with virtually no interest in real estate mortgage loans. The average national bank held $ 762,000 in secured and unsecured commercial loans in 1911, but less than $ 10,000 in real estate mortgage loans. n166 For state banks and savings institutions the situation was nearly the reverse -- depository institutions other than national banks owned an average of $ 173,000 in real estate mortgage loans and $ 258,000 in secured and unsecured commercial loans in 1911. n167 In times of inflation, the national banks were better off than state institutions. A substantial percentage of national banks' portfolios in commercial loans could be rolled over each year and thus tagged with new nominal interest rates. State institutions, on the other hand, with their heavy commitment to long-term mortgage lending, took on a substantially greater interest rate risk which redounded to their disadvantage in times of high nominal interest rates. In this respect, smaller institutions appear to have suffered more than larger ones during the period from 1907 to 1911.

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n166. See 1911 REPORT, supra note 61, at 58.

n167. See id.

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Fifth, larger banking institutions were often themselves engaged in a securities business. n168 Banks underwrote corporate bonds by purchasing them and reselling them to customers. They also provided investment counseling to customers, n169 including individuals of limited resources, "advising against their tendency to sacrifice strength for large yield." n170 Most of the banks engaged in bond underwriting were the large institutions in New York, Chicago, and other "money centers," but even some smaller commercial banks provided investment services. The Commerce Trust Company of Toledo, for example, instituted a program under which customers could purchase Toledo City Bonds

for ten dollars down on an "easy payment plan." n171 Privately held bond portfolios also increased the demand for bank safe deposit services, which produced income and, more [*376] importantly, brought the customer into the bank on a regular basis where he or she might be inclined to make deposits or apply for loans. Banks with bond departments also enjoyed an inside track with the customer for making loans on the security of the customer's portfolio and, by clipping the customer's coupons, could gain substantial influence over the customer's reinvestment decisions. n172 Small banks and savings institutions, on the other hand, were ordinarily not engaged in the securities business to any appreciable extent, n173 and so could not share in these benefits.

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n168. At the time, such activities were perfectly legal for banks. Indeed, the distinction between banks and investment banks, so common today, was not well defined in 1911. Investment bankers would not split from the American Bankers Association and establish their own Investment Bankers Association until 1912. See George B. Caldwell, Address of Chairman, 1912 IBA PROCEEDINGS, supra note 59, at 16.

n169. See Robert D. Coard, Service Rendered to Investors by a Properly Conducted Bond Department, 84 BANKERS MAG. 44, 44-45 (1912).

n170. Id. at 45.

n171. See How Banks Are Advertising, 88 BANKERS MAG. 200, 204 (1914).

n172. See Coard, supra note 169, at 45 (stating that a bank should act as a friend to investors by negotiating loans against their holdings, encouraging their savings habits, and collecting and reinvesting their interest and principal for them).

n173. See CAROSSO, supra note 7, at 84-85 (observing that not until assets held in banks "more than doubled" in the first decade of the twentieth century did "country banks in the Middle and Far West, which previously had invested almost exclusively in farm mortgages, [start] buying railroad, industrial, and utility bonds"); see also id. at 95-96 (setting out a two-level hierarchy of banks involved in securities between 1900 and 1910: the four "great international banking houses" and some two hundred "secondary firms").

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Finally, the big banks, like the big securities firms, had come under fire in the popular resentment against Wall Street during the first decade of the century. n174 Big banks thus had good reason to oppose new regulatory initiatives which might result in precedents harmful to their long-run interests. Small banks were never the targets of populist resentment of this sort. n175

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n174. See id. at 110 (discussing "popular concern with . . . the increasing concentration of economic and financial power in New York" which climaxed in 1914 and manifested itself as distrust of big banks, securities firms, and life insurance companies).

n175. See id. (noting that "Americans traditionally harbored hostility toward monopoly, privilege and concentrated wealth" and that they shared their concern about big banks with small bankers and businesspeople).

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Larger banks, while sympathetic in some respects with the general objectives of blue sky regulation, opposed the statutes themselves from the start. Bankers Magazine, a journal principally serving the interests of urban commercial banks, reflected these attitudes when it editorialized against the blue sky laws in 1912. Bankers Magazine warned that the blue sky laws would create "a nation of fools and weaklings" by protecting people against their own folly. n176 The editorial continued that in states adopting Kansas-style statutes, "through ignorance, prejudice -- and possibly from some unworthy motive -- many excellent securities may be debarred from some of the States." n177

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n176. The "Blue Sky" Laws, supra note 59, at 635.

n177. Id. at 635-36. In contrast to the position taken by Bankers Magazine, the American Banker, which placed greater emphasis on smaller banks than its competitor, took a somewhat schizophrenic position in 1913, commenting that blue sky laws were "good, some better," but that Kansas-style legislation was inappropriate for "conditions such as exist in New York State -- and City." Blue Sky Laws in New York, 78 AM. BANKER 1000, 1000 (1913).

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[*377] Larger banking interests' opposition to Kansas-style blue sky laws also reflected an awareness of the possibility that state regulation might itself represent competition for banks offering investment advisory services or securities placement services. That attitude was evident in another Bankers Magazine editorial, which, after excoriating "get-rich-quick" artists, concluded that "[i]f all legitimate promotion schemes were required first to secure the partial approval of a bank of recognized standing, it would go a long ways toward curtailing the operations of fraudulent schemers." n178 The "most reliable certificate of the quality of any security," said another editorial, is "that to be had from a responsible bank, trust company or bond house. In fact, this [e]ndorsement is worth more than that of any State official, for it generally represents sound financial judgment." n179

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n178. Using Banks as Decoys in Promotion Schemes, supra note 43, at 302.

n179. The "Blue Sky" Laws, supra note 59, at 636.

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V. State Legislation in 1912-1913

The actual success -- or lack of it -- of the Kansas law notwithstanding, its impact as a precedent was unmistakable. News of the legislation quickly sparked efforts to regulate the sale of speculative securities in other states.

Arizona n180 and Vermont n181 adopted blue sky legislation patterned on the Kansas model in 1912. Louisiana enacted a statute that year requiring securities dealers to obtain a license and post bond, and creating civil and criminal liability for false statements in connection with securities sales. n182 The Louisiana statute differed significantly from the Kansas model because it did not authorize the banning of a security from the state on the ground that it did not promise a fair return on the investment. n183

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n180. Act of May 18, 1912, ch. 69, 1912 Ariz. Sess. Laws 338 (vesting enforcement powers in the state corporation commission).

n181. Act of Feb. 13, 1913, No. 170, 1912 Vt. Laws 196 (vesting enforcement power in the state bank commissioner).

n182. Act of July 1, 1912, No. 40, 1912 La. Acts 47.

n183. Id. @ 1, 1912 La. Acts at 47.

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State regulatory activity accelerated through 1913. Eight states adopted legislation closely patterned on the Kansas model, granting a designated agency the power to reject proposed issues which did not offer a fair return on a buyer's investment: Arkansas, n184 Idaho, n185 Michigan, n186 Montana, n187 North Dakota, n188 South Dakota, n189 [*378] Tennessee, n190 and West Virginia. n191 The Province of Manitoba enacted the Kansas blue sky law almost verbatim in 1912. n192 Ohio enacted a statute which, while not directly patterned on the Kansas model, permitted the relevant state authority to reject a security if the issuer's "proposed disposal of its securities . . . is . . . on unfair terms." n193

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n184. Arkansas Securities Act, No. 214, @ 6, 1913 Ark. Acts 904, 909-11.

n185. Idaho Securities Act, ch. 117, 1913 Idaho Sess. Laws 454, 455-56.

n186. Act of May 2, 1913, No. 143, @ 5, 1913 Mich. Pub. Acts 243, 245-46.

n187. Act of Mar. 13, 1913, ch. 85, @ 9, 1913 Mont. Laws 367, 370-71.

n188. Supervision of Investment Companies, ch. 109, @ 5, 1913 N.D. Laws 137, 139-40.

n189. Act of Mar. 14, 1913, ch. 319, @ 5, 1913 S.D. Laws 522, 524.

n190. Act of Sept. 27, 1913, ch. 31, @ 5, 1913 Tenn. Pub. Acts 500, 502-03.

n191. Act of Feb. 6, 1913, ch. 15, @ 5, 1913 W. Va. Acts 114, 117-18.

n192. Sale of Shares Act, 1913, 2 Geo. 5, ch. 75.

n193. Act of Apr. 28, 1913, @ 16, 1913 Ohio Laws 743, 751-52.

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Blue sky legislation based on the Kansas model proved less successful elsewhere. Securities regulation laws made no headway in states such as Nevada, Maryland, and Delaware which were active participants in the corporate chartering market. n194 The Indiana legislature approved a blue sky statute only to see it vetoed by the governor after intense lobbying by a coalition of investment bankers and manufacturers. n195 Blue sky legislation was also vetoed in Colorado. n196 Illinois and n Pennsylvania -- states with active securities industries and large manufacturing firms -- rejected proposals for Kansas-style statutes. n197 A blue sky law was also proposed, and apparently defeated, in Minnesota. n198

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n194. See RIPLEY, supra note 38, at 219 (noting that Delaware and Nevada had no securities regulation and that Maryland had "merely investigation and injunction laws"); see also id. at 16-20 (discussing Delaware and Nevada as highly active in producing "corporate progeny"). South Dakota, however, adopted blue sky legislation in 1913 despite its active participation in the competition for charters. See id. at 29.

n195. See supra note 154 and accompanying text.

n196. Brief for Appellees Other than the Weis Fibre Container Corporation at 45, Merrick v. N. W. Halsey & Co., 242 U.S. 568 (1917) (No. 413).

n197. See Reed, supra note 140, at 66.

n198. Cf. Minneapolis and St. Paul, 78 AM. BANKER 709, 709 (1913).

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Other states, while adopting securities regulation statutes, rejected essential features of the Kansas model. Missouri n199 and Florida n200 adopted legislation modeled on the Kansas statute, but omitting the crucial power to reject a sale of securities if the offering did not promise a fair return on the investment. n201 Maine, another competitor for corporate charters, n202 adopted a modified disclosure regulation patterned generally on legislation recommended by the Investment Bankers Association (IBA), n203 which required registration of securities dealers n204 and imposed [*379] penalties for fraudulent statements about securities or dealers. n205 Other jurisdictions requiring registration and disclosure and prohibiting fraud, but not permitting the exclusion of securities solely because they were bad investments, were Georgia, n206 Iowa, n207 Nebraska, n208 North Carolina, n209 Oregon, n210 Texas, n211 and Wisconsin. n212 California adopted a statute which applied only to initial securities offerings, not secondary trading, n213 and which permitted securities brokers to obtain a general exemption to sell securities of any sort upon proof of good reputation. n214

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n199. Act of Apr. 7, 1913, C.S.S.B. 78, 79, 1913 Mo. Laws 112.

n200. Act of May 20, 1913, 1913 Fla. Laws ch. 6422.

n201. Despite the difference between this statute and the Kansas law, the Missouri official charged with its administration journeyed to Topeka to study the administration of that state's law in preparation for the implementation of the new Missouri statute. St. Louis, Mo., 78 AM. BANKER 1988, 1989 (1913).

n202. See RIPLEY, supra note 38, at 31-33 (describing Maine's aggressive attempts to lure corporate charters).

n203. For a description of the IBA's activities in opposing blue sky legislation on the Kansas model, see supra notes 140-49 and accompanying text (describing efforts by the IBA to block passage or enactment of such laws); and infra notes 227-34 and accompanying text (describing in IBA's efforts to force repeal or amendment of newly enacted blue sky provisions).

n204. Act of Apr. 9, 1913, ch. 209, @ 21, 1913 Me. Laws 291, 292.

n205. Id. @ 12, 1913 Me. Laws at 297.

n206. Act of Aug. 19, 1913, No. 263, 1913 Ga. Laws 117.

n207. Act of Apr. 19, 1913, ch. 137, 1913 Iowa Laws 137.

n208. Act of Apr. 21, 1913, ch. 199, 1913 Neb. Laws 603.

n209. Act of Mar. 12, 1913, ch. 156, 1913, N.C. Sess. Laws 249.

n210. Act of Feb. 28, 1913, ch. 341, 1913 Or. Gen. Laws 668.

n211. Act of Aug. 21, 1913, 33d Leg., 1st C.S., ch. 32, 1913 Tex. Gen. Laws 6 66.

n212. Act of Aug. 21, 1913, ch. 756, 1913 Wis. Laws 1108.

n213. Investment Companies Act, ch. 353, @ 2(e), 1913 Cal. Stat. 715, 715.

n214. Id. @ 6, 1913 Cal. Stat. at 718.

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In Massachusetts -- a state with a significant population of issuing firms and the location of a leading regional securities exchange n215 -- a legislative commission recommended against adoption of a Kansas-style law in 1912. The commission noted that securities sales in Massachusetts were usually made through bankers and brokers in the state and "no complaints had been presented . . . as to their operations." n216 The commission recommended a version of the IBA's proposed statute without merit regulation. n217 Such a statute was introduced in the Massachusetts legislature in 1913. n218

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n215. See CAROSSO, supra note 7, at 44 ("The Boston Stock Exchange was the principal market for industrial securities before 1900.").

n216. C.A. Dykstra, Blue Sky Legislation, 7 AM. POL. SCI. REV. 230, 232-33 (1913).

n217. See id. at 233.

n218. See Massachusetts' "Blue Sky" Law, 78 AM. BANKER 1825, 1825 (1913) (describing the principal features of the Massachusetts statute, which included: financial disclosure by companies whose securities are for sale in the state; mandatory licensing requirements and reporting regulations for brokers doing business in the state; and state-sponsored oversight of securities marketing and transactions).

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In New York a fierce battle broke out between those favoring Kansas-style legislation -- presumably agrarian and upstate interests -- and the securities industry and stock exchanges. The state assembly adopted a Kansas-style bill in 1913, n219 but the IBA organized to kill the bill in the state senate. n220

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n219. See Blue Sky Laws in New York, supra note 177, at 1000 (explaining the bill as a "crude attempt to copy some of the 'blue sky' legislation of other states").

n220. See Hearing on "Blue Sky" Bill, supra note 155, at 1008 (reporting that the New York members of the IBA were opposed to the bill and were calling for hearing on the matter); PARRISH, supra note 7, at 11 ("The IBA's powerful New York constituency persuaded the state senate to kill the [license law] . . . .").

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[*380] Thus, between 1911 and 1913, the states adopting Kansas-style blue sky legislation were generally ones without a significant investment banking industry and with powerful farming interests. n221 States rejecting blue sky regulation altogether tended to fall into one of two categories: states such as Maine, Delaware, Nevada, and Maryland, which, although generally rural and hence natural candidates for blue sky laws, were bidding for corporate charters at the time; n222 and states with large securities or manufacturing interests -- namely, New York, Pennsylvania, Massachusetts, Illinois, and Indiana. n223 However, the drive for blue sky legislation made some headway in two of these states with powerful farming interests -- New York and Indiana. n224 The remainder of the states that adopted modified blue sky laws, without the feature of merit regulation that distinguished the Kansas statute, n225 appear to have effected a compromise between competing political forces.

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n221. See supra notes 180-91 and accompanying text (chronicling the passage of blue sky laws in Kansas and other predominantly agricultural states in 1911, 1912, and 1913).

n222. See supra notes 194, 202-05 and accompanying text (discussing the opposition to blue sky legislation in states which were active in the corporate chartering market).

n223. See supra notes 195, 197-98 and accompanying text (describing the fate of blue sky proposals in several manufacturing states); supra notes 215-20 and accompanying text (detailing legislative responses in states with strong securities interests).

n224. See supra text accompanying notes 195, 219-220.

n225. See supra notes 199-201, 206-14.

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VI. The Hiatus of 1914

Surprisingly, although blue sky laws flourished in 1913, the legislative activity stopped abruptly in 1914. No state adopted a blue sky statute that year. The collapse in the momentum for blue sky legislation after 1913 was the result of four principal factors.

First, the drive for blue sky laws in 1913 had been given an artificial push by the election of 1912, which was deeply concerned with attitudes towards the financial industry. To tap the prevailing public distrust of "Wall Street," many candidates for office at the state level endorsed the general concept of regulating securities swindlers. n226 In light of the tenor of the times, it would probably have been unwise for a candidate to take any other position. The political promises made in 1912 had been cashed in by 1913.

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n226. See "Blue Sky" Legislation in Indiana, supra note 153, at 921 (observing that in recent campaigns many governors promised legislation regulating dealers in fraudulent securities).

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Second, states in which blue sky legislation was likely to be most popular -- rural states without large manufacturing interests or major [*381] securities firms -- had already adopted legislation by 1913. Additional legislation would be more difficult to achieve in the remaining states.

Third, the constitutionality of blue sky legislation, which had not been a substantial issue during the outpouring of statutes the previous year, was called into serious question in 1914, largely due to vigorous test-case litigation by the IBA. n227 These litigation tactics proved stunningly successful in a series of decisions in 1914 and 1915. n228

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n227. The IBA spent the then enormous sum of $ 22,429 supporting test cases during the year ending August 31, 1914. INVESTMENT BANKERS ASSOCIATION, PROCEEDINGS OF THE THIRD ANNUAL CONVENTION 66 (1914) [hereinafter 1914 IBA PROCEEDINGS].

n228. See, e.g., Geiger-Jones Co. v. Turner, 230 F. 233 (S.D. Ohio 1916), rev'd, 242 U.S. 539 (1917); N.W. Halsey & Co. v. Merrick, 228 F. 805 (E.D. Mich. 1915), rev'd, 242 U.S. 568 (1917); Bracey v. Darst, 218 F. 482 (N.D. W. Va. 1914); William R. Compton Co. v. Allen, 216 F. 537 (S.D. Iowa 1914) (per curiam), cert. dismissed, 239 U.S. 652 (1915). In several of these cases, the plaintiffs were securities firms located in New York, Illinois, or other states with active securities industries and their lawyers were the elite corporate bar of the day. See Reed, supra note 7, at 180 n.3.

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In Alabama & New Orleans Transportation Co. v. Doyle, n229 the court condemned the Michigan blue sky law for going far beyond its stated purpose of "stop[ping] the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations." n230 The statute would have been perfectly constitutional if its effect were merely to prohibit fraudulent practices. But, in the court's view, it exceeded the state's police powers by prohibiting the sale of securities that were "honest, valid and safe" and by preventing experienced investors from purchasing securities which in the investor's estimation gave "sufficient promise of gain to offset the risk of loss." n231 Courts also invalidated blue sky statutes on the ground that they interfered with the free flow of interstate commerce n232 and infringed on the privileges and immunities of national citizenship. In a decision striking down the Iowa blue sky law, the court observed:

The mere reading of the act in question makes entirely clear . . . that it does impose burdens upon and denies privileges to citizens of other states which are not imposed upon and which are granted to citizens of Iowa. That such favoritism of the law of a state to its citizen subjects as this act grants cannot be successfully defended, no matter [*382] how laudable the purpose sought to be accomplished thereby may be though to be, would appear settled . . . n233

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n229. 210 F. 173 (E.D. Mich. 1914).

n230. Id. at 175.

n231. Id.

n232. See id. at 182-83. Significantly, the plaintiffs in the Doyle case -- rather clearly selected by the IBA for test-case purposes -- were out-of-state securities firms and a holder of the securities of an out-of-state issuer. Id. at 177-78. The decision earned the praise of the editors of Bankers Magazine, who denigrated the Michigan statute as a "ridiculous and wholly unnecessary infringement on the rights of legitimate business." "Blue-Sky" Laws Obscured by a Judicial Cloud, 88 BANKERS MAG. 283, 283 (1914). The magazine again called for a "clear, simple Federal enactment prescribing regulations under which those offering stocks and bonds for sale might be admitted to the use of the mails." Id. at 284.

n233. William R. Compton Co. v. Allen, 216 F. 537, 549 (S.D. Iowa 1914), cert. dismissed, 239 U.S. 652 (1915).

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As a result of these decisions, many IBA members were confident by 1914 that they had overcome the blue sky threat. n234 It would have been difficult for even the most sanguine advocates of blue sky legislation to disagree with this assessment after reading the sweeping and apparently unanimous decisions striking down the blue sky laws.

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n234. See 1914 IBA PROCEEDINGS, supra note 227, at 67 (report of the committee on legislation) (asserting that IBA members need not worry about the threat of the blue sky laws any longer).

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A final reason for the cessation of blue sky activity was that the economic situation of larger banking and securities firms, although not that of the smaller (mostly state-chartered) banks, changed dramatically during 1914. n235 The outbreak of war in Europe precipitated a crisis in big banks and securities firms in 1914 as a result of massive gold hoarding by foreign investors that depleted the gold reserves held at New York banks. n236 The New York Stock Exchange closed on July 31, 1914, "[t]o prevent threatened demoralization," and did not fully reopen until mid-December. n237 The average deposit base at national banks, which had grown to $ 827,000 in June 1914, n238 dropped after the crisis in July and August, falling to $ 810,000 by September 1914. n239 The Comptroller of the Currency evaluated the situation and opined: "The financial situation in New York was acute, and it was apparent that the effect of the European war on the banks and other financial institutions in the country would be threatening and deep-reaching." n240 It seems probable that these highly adverse financial conditions, which affected the major banks, securities firms, and [*383] securities markets far more than state-chartered banks or smaller businesses, may have contributed to the general loss of momentum for blue sky legislation during 1914.

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n235. Conditions at the smaller banks appeared to have been quite similar to those prevailing over the previous several years. The inflation and high interest rates which contributed to the initial blue sky movement, see supra notes 27-31, 164 and accompanying text, continued unabated. Bond prices continued to drop, falling in the case of the bellwether 1925 United States issue from a low of 113 3/4 in 1911 to a low of 108 3/4 in 1914. Compare supra note 164 with 2 ANNUAL REPORT OF THE COMPTROLLER OF THE CURRENCY 51 (1916) [hereinafter 1916 REPORT]. State banks had increased their deposit bases and holdings of investment securities since 1911, but not dramatically -- their average securities holdings in 1914 were $ 27,000, compared with $ 25,000 in 1911. Compare 2 1914 REPORT, supra note 165, at 676-77, with supra text accompanying note 161. Over the same period, average total individual deposits at state banks rose from $ 215,000 to $ 222,400. See 2 1914 REPORT, supra note 165, at 680-81. The indication from these figures is one of slight improvement, but not enough to alter the political stance of state bankers with respect to the blue sky laws.

n236. See 1 1914 REPORT, supra note 165, at 12 (reporting that New York banks "faced a serious crisis" because a large amount of gold exports to Europe had drawn heavily on their resources).

n237. Id. See generally ROBERT SOBEL, THE BIG BOARD, A HISTORY OF THE NEW YORK STOCK MARKET 206-13 (1965) (chronicling the background of the 1914 closure of the Exchange).

n238. See 1 1914 REPORT, supra note 165, at 44-45.

n239. See id.

n240. Id. at 13.

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VII. The Failed Compromise of 1915 and the New Blue Sky Laws of 1916

Economic conditions changed dramatically in 1915. European money suddenly flooded into the country for safekeeping, n241 interest rates eased, n242 and war-related orders from abroad brought unprecedented increases in exports. n243 The Comptroller of the Currency exulted in 1916 that the country was experiencing "the greates prosperity it has ever known" and that "[t]he activity manifested in virtually every occupation and in every kind of industry and in all sections has been unprecedented." n244

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n241. "[G]old came to New York to settle accounts for imports, for investment in safe industries, and for participation in the American bull market. Gold imports in 1915 were 661.9% over those of 1914." SOBEL, supra note 237, at 213-14.

n242. The bellwether U.S. bonds of 1925, which had been trading at a low of 108 3/4 in 1914, reached a high of 112 in 1916. See 2 1916 REPORT, supra note 235, at 52-53.

n243. The nation's trade surplus increased 438.8% over the previous year. SOBEL, supra note 237, at 213.

n244. 1 1916 REPORT, supra note 235, at 1.

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Major beneficiaries were the state-chartered banks, especially outside major urban areas, that had suffered from a dearth of deposits in previous years, n245 as well as smaller businesses that obtained financing from these banks. n246 The Comptroller remarked that "banking capital is to-day more widely and more equitably distributed over the country than ever before in this generation." n247 National banks grew even more explosively during the period, n248 with average total individual deposits in national banks rising from $ 810,000 in 1914 to $ 1,115,000 in 1916. n249

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n245. Total deposits in state banks rose from $ 3,227 million in 1914, to $ 4,296 million in 1916. Compare 2 1914 REPORT, supra note 165, at 861 with 2 1916 REPORT, supra note 235, at 863.

n246. See 1 1916 REPORT, supra note 235, at 2 (noting that "[b]usiness men, large and small, in the smaller cities and also in towns and rural districts, as well as in the centers of wealth, are now enabled to obtain capital . . . on terms more favorable than ever experienced in the past").

n247. 1 1916 REPORT, supra note 235, at 1.

n248. See Good Year for the National Banks, 94 BANKERS MAG. 241, 241 (1917) (reporting that national banks received their highest earnings in history in 1916, both net and gross, according to figures compiled by the Comptroller of the Currency).

n249. Compare 1 1914 REPORT, supra note 165, at 44-45 with 1 1916 REPORT, supra note 235, at 2, 37.

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The greatly improved financial position of smaller banks -- and their significantly increased portfolios of bonds and other securities -- seems to have reduced their interest in blue sky legislation. Complaints about speculative securities are virtually absent from the leading banking journals [*384] in 1915. Such evidence as we have suggests a considerable softening of views among smaller banks. The American Banker, which had taken the editorial position in 1913 that blue sky legislation was "good" in smaller states but ill-advised in New York, n250 now reprinted with apparent approval a Wall Street Journal editorial fiercely attacking Kansas-style statutes. n251

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n250. See supra note 177.

n251. Blue Sky Laws, 80 AM. BANKER 4011 (1915).

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By 1915, accordingly, events had transpired to narrow the differences between investment bankers and their chief rivals in the blue sky fight -- the state bank regulators. The constitutionality of blue sky legislation -- at least legislation based on the Kansas model -- was very much in doubt. Even the state bank supervisors accepted this fact. n252 The IBA had consolidated an effective lobby of bond issuers and investment banks to combat future Kansas-style regulation. n253 Meanwhile the smaller banks and borrowers, which had been the chief proponents of blue sky legislation, had begun to prosper, thus greatly reducing concerns about losing deposits or loan funds. Conditions appeared propitious for a compromise that would finally settle the blue sky issue.

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n252. See 1914 IBA PROCEEDINGS, supra note 227, at 76 (report of Caldwell, Masslich & Reed).

n253. See CAROSSO, supra note 7, at 186 (noting that "the IBA was fighting the spread of state regulation in the courts" and that "[t]he association's fire was directed specifically against statutes of the Kansas type").

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Representatives of the two groups -- state bank supervisors and the IBA -- met in 1915 and hammered out new model legislation n254 under which persons proposing to sell securities in a state were required to notify a state official, who would be authorized to investigate and to prosecute persons found to be selling securities by means of any scheme or artifice to defraud. n255 State securities administrators would not be authorized under this model legislation to prohibit sales of securities on the ground that they did not promise a sufficient profit or were otherwise not "fair" or meritorious. n256 This draft legislation provided the basis for a Virginia statute enacted in 1916. n257

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n254. Reed, supra note 7, at 180 n.3; INVESTMENT BANKERS ASSOCIATION, PROCEEDINGS OF THE FOURTH ANNUAL CONVENTION 186 (1915) (report of Robert R. Reed) [hereinafter 1915 IBA PROCEEDINGS]. The recommendations of the National Association of Supervisors of State Banks are reported in Blue Sky Legislation, 80 AM. BANKER 3931 (1915).

n255. Reed, supra note 7, at 180 n.3; see 1915 IBA PROCEEDINGS, supra note 254, at 192-94 (report of Robert H. Reed).

n256. Counsel for the IBA issued an opinion explaining how the investment bankers' bill passed constitutional scrutiny, as a reasonable police power regulation, while Kansas-style regulation did not. See The Blue Sky Laws, 91 BANKERS MAG. 588, 589-90 (1915).

n257. Act of Mar. 23, 1916, ch. 499, 1916 Va. Acts 835.

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This compromise might have resolved the controversy if it had been achieved in 1913 instead of 1915. But by 1915, when the IBA finally [*385] settled its differences with the banking commissioners, the administrative power over blue sky regulation had fallen into other hands in many states. Although some states vested blue sky enforcement in their banking commissioners, others placed the authority in the hands of the railroad commissioner, n258 the commissioner of corporations, n259 the secretary of state, n260 the state auditor, n261 or in specialized securities regulators. n262 It is not clear whether the state banking commissioners carried proxies from these other regulators into their negotiations with the IBA.

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n258. See, e.g., Act of Apr. 21, 1913, ch. 199, 1913 Neb. Laws 603.

n259. See, e.g., Act of May 18, 1912, ch. 69, 1912 Ariz. Sess. Laws 338.

n260. See, e.g., Act of July 1, 1912, No. 40, 1912 La. Acts 47.

n261. See, e.g., Act of Feb. 6, 1913, ch. 15, @ 5, 1913 W. Va. Acts 114.

n262. See, e.g., Act of May 2, 1913, No. 143, 1913 Mich. Pub. Acts 243.

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Moreover, the IBA's test case litigation strategy, effective as it had been at casting constitutional doubt on the blue sky statutes, also introduced state attorneys general into the picture, who were charged with defending their states' statutes in court. It is clear that the state banking commissioners did not negotiate on behalf of these officials. To the IBA's dismay, the association of state attorneys general refused to go along with the deal that had been struck between the IBA and the state banking commissioners. n263 The attorneys general insisted both on prosecuting the appeals in the blue sky cases to the Supreme Court and on drafting their own model legislation. n264

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n263. See Brief for Appellees at 48-49, Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917) (No. 413).

n264. See id.

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This legislation departed from the Kansas model in that it did not explicitly authorize paternalistic rejections of proposed securities sales when the government official felt that the instrument in question did not offer a fair return. It did, however, substitute a prohibition on the sale of securities which would "work a fraud" upon the purchaser. n265 The Michigan legislature enacted a statute based on the attorneys general's model, n266 and several other states followed suit. n267

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n265. See Amicus Curiae Brief at 11, Hall v. Geiger-Jones Co., 242 U.S. 539 (1917), Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917), Merrick v. Halsey & Co., 242 U.S. 568 (1917) (Nos. 413, 438-40, 860).

n266. Act of Apr. 9, 1915, No. 46, 1915 Mich. Pub. Acts 63.

n267. See Reed, supra note 7, at 181 n.4.

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We do not have information on the interests pushing this mini-revival of blue sky legislation. Our inference is that the states adopting the attorneys general's model did so principally at the behest of the attorneys general themselves rather than as a result of any renewed outpouring of political pressure from small banks or local borrowers, but the matter is conjectural without firmer evidence. Whatever the cause of these statutes, [*386] however, it was evident that the 1915 attempt at compromise failed to resolve the problem.

VIII. The Blue Sky Cases of 1917

Despite the failure of the compromise of 1915, the IBA hoped for vindication in the Supreme Court. A Supreme Court decision affirming the lower court blue sky cases would severely cripple the Kansas-style regimes of merit regulation. States wishing to continue securities regulation would have to overhaul their statutes and substitute some version of the IBA's proposed registration and antifraud legislation.

When the decisions were announced in 1917, however, it was the Kansas-style blue sky laws, and not the IBA, that received vindication. n268 Writing for the Court in Merrick, Justice McKenna held that it was within a state's police power to prevent deception in the sale of securities. n269 The statute admittedly burdened honest businesses, but only so that "dishonest business may not be done." n270 Although this might admittedly cause expense and inconvenience, said McKenna, "to arrest the power of the state by such considerations would make it impotent to discharge its function. It costs something to be governed." n271

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n268. See Merrick v. Halsey & Co., 242 U.S. 568 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Hall v. Geiger-Jones Co., 242 U.S. 539 (1917). Of these three cases, only the Michigan statute represented a true test case for the securities industry; the other two, to the dismay of securities industry strategists, involved the sort of fly-by-night enterprises that the blue sky laws were ostensibly designed to prevent. See Reed, supra note 7, at 180 n.3.

n269. Merrick, 242 U.S. at 588.

n270. Id. at 587.

n271. Id.

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With respect to the alleged burdens on interstate commerce, the Court observed that the statute in question applied only to dispositions of securities within the state: "Upon their transportation into the state there is no impediment." n272 Thus, because the statutes in question affected the securities in question only when a disposition of them was attempted within the state, the interference with interstate commerce was "only incidental[]" and therefore within the state's constitutional authority. n273

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n272. Hall, 242 U.S. at 557.

n273. Id. at 559.

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The decisions in the Blue Sky Cases, on first blush, could not have been worse for the IBA or better for its opponents. The Supreme Court had flatly repudiated all the lower court opinions in the IBA's favor and had ruled

against the IBA point-by-point on the constitutional issues. It was perfectly evident, in the wake of the Supreme Court's decisions, that any state wanting to adopt Kansas-style blue sky legislation was free to do [*387] so as far as the federal Constitution was concerned. The IBA's litigation strategy had apparently ended in catastrophe.

Yet the Blue Sky Cases did not, in fact, represent a defeat for the investment bankers -- at least as far as their actual business interests were concerned -- for two important reasons. First, because the IBA had already effectively vitiated the most burdensome elements of the state blue sky laws by 1917, the Supreme Court's endorsement of those laws did little but subject the IBA's members to additional annoyance. Throughout the period from 1913 to 1917 the IBA had been continuously active in the state legislatures. Its strategy was not to seek a repeal of blue sky statutes, but rather to obtain reasonable exemptions to allow "safe" securities to be sold without the need to comply with the burdensome rules applicable to more speculative issues. The IBA was quite successful in this strategy. We have already seen that even by 1913 the IBA was able to influence a large number of states to reject Kansas-style merit regulation in favor of milder regulatory approaches, including nine states which adopted legislation patterned on the IBA's proposed statute. n274

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n274. See supra notes 202-14 and accompanying text.

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The IBA continued to enjoy success in this campaign during 1915 and thereafter. Many states added exemptions to their blue sky statutes to allow the sale of most of the securities with which the IBA dealt. n275 Even Kansas amended its statute in 1915, restricting its coverage to "speculative" securities, defined to include "securities into the specified par value of which the element of chance or hazard . . . equal[s] or predominate[s] over the elements of reasonable certainty, safety and investment" and "securities to promote or induce the sale of which, profit, gain, or advantage unusual in the ordinary course of legitimate business is in any way advertised or promised." n276 Other states followed the lead of Nebraska and Wisconsin and exempted securities listed on major stock exchanges. n277 Still others exempted securities listed on a standard manual of information approved by the designated authority n278 -- this would exempt aftermarket trading in the securities of most large corporations listed on major exchanges. n279 The effect of these statutory changes was [*388] to provide a relatively free market within many states for the types of securities underwritten by the IBA's members and issued by major manufacturers, railroads, and public utilities -- the IBA's allies in the campaign against Kansas-style legislation from 1912 to 1913.

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n275. See, e.g., Act of Mar. 15, 1915, ch. 275, 1915 S.D. Laws 657, 659; Act of Apr. 12, 1915, ch. 149, 1915 Iowa Acts 182, 183.

n276. Act of Mar. 23, 1915, ch. 164, 1915 Kan. Sess. Laws 195. J. N. Dolley had acknowledged as early as 1912 that the original 1911 law was too harsh and that an exception should be added for the issuance of general licenses to reputable investment bankers to sell stocks and bonds of their choosing,

provided that "they handle nothing but first class securities and their reputations along other lines are found satisfactory [to] the Bank Commissioner . . . ." J. N. Dolley, Dolley Defends Kansas Blue Sky Law, 77 AM. BANKER 4416, 4416 (1912).

n277. See supra notes 208, 212 and accompanying text.

n278. See, e.g., Act of Mar. 15, 1915, ch. 275, 1915 S.D. Laws 657; Act of Apr. 9, 1915, No. 46, 1915 Mich. Pub. Acts 63.

n279. An example of a standard manual was Moody's Manual of Railroads, listing information on railroad lines. See Brief for Appellees at 20, Merrick v. N. W. Halsey & Co., 242 U.S. 568 (1917) (No. 413). Because listing was in the discretion of publishers and did not discriminate between sound and questionable corporations, the standard manuals may not have provided accurate information about security values. See id. at 19-20.

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The other reason the Blue Sky Cases did not represent a defeat for the investment bankers is found in the Hall case. While upholding the blue sky statute at issue in the case, Justice McKenna pointedly observed that it imposed no impediment on the transportation of securities to a state, only on the sale or disposition of securities once they had entered the state's borders. n280 The clear implication was that the sale of a security by mail could not constitutionally be regulated at the state level. By the same token, promotion of a security by interstate mail or telephone calls could not be regulated by the blue sky laws. And, although McKenna's opinion did not speak to this issue directly, it also seemed clear, given First Amendment considerations, that states would incur a substantial risk of invalidation if they attempted to regulate the promotion of securities by means of newspapers or other media -- at least as long as the advertisement in question proposed a transaction to take place outside of the state's borders.

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n280. Hall v. Geiger-Jones Co., 242 U.S. 539, 559 (1917).

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By 1917, in short, a wide variety of alternative marketing mechanisms were available to the IBA -- and indeed, available to the "fly-by-night" hawkers of speculative securities -- and there appeared to be little that the states could do to prevent this activity under their blue sky laws. The IBA and others in the banking and investment community had been aware of the potential for securities sales by means of the mails or other modalities of interstate commerce for years. n281 The Kansas blue sky law was being cir-cumvented my mail solicitations as early as 1912. n282 In 1915, two years before the Supreme Court's Blue Sky Cases, the IBA's counsel had circulated an opinion concluding that "dealers may, as a matter of law, safely ignore these [blue sky] laws in strictly interstate transactions." n283 The opinion went on to advise dealers "that in handling interstate business [*389] by mail they endeavor as far as possible . . . to meet the views of the administrative officials of the States," but that "they should feel practically safe in ignoring the laws, at least for the purpose of making offerings by mail." n284 This opinion proved to be a

charter for the business of unregulated interstate securities sales by mail that burgeoned in the wake of the Supreme Court's Blue Sky Cases.

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n281. See, e.g., Smith, supra note 151, at 2999 ("[A blue sky law] cannot stop the United States mails from other States, nor the salesman who does not himself deliver his goods, but takes the order back to Chicago or New York. It can and will stop the Michigan industry which should have immediate financing.").

n282. See Topeka, Kans., 78 AM. BANKER 358, 358 (1913) (reporting that some companies refused permission to sell securities in Kansas under the blue sky law "have evaded it by advertising in the Kansas papers, and a considerable number of Kansas people invested money in the concerns").

n283. The Blue Sky Laws, supra note 256, at 590.

n284. Id.

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We reach the end of our chronological study with what might be called a Pyrrhic defeat for the IBA. Blue sky legislation had been adopted in many states, yet even states that followed Kansas with merit regulation were enacting broad exemptions allowing elite investment bankers to sell high-grade securities with only minimal regulatory interference. The IBA was soundly trounced in the Supreme Court, yet emerged with broad powers to sell securities in all states -- even those which had not granted generous exemptions from the regulatory requirements by affirmative legislation. These conditions would generate a new round of concerns about speculative securities sales after the Armistice and renewed calls for legislation, this time primarily at the federal level, ultimately leading to the enactment of the Federal Securities Act of 1933. That, however, is a different story.

IX. Justifications for Blue Sky Legislation

It may be useful to examine the justifications advanced by the proponents of blue sky legislation, especially legislation on the Kansas model that permitted prohibition of securities sales solely on the ground that they did not promise an adequate rate of return for the investor or that they were too speculative. To what degree were these justifications actually supported by the evidence?

At the time of their enactment, the blue sky laws were typically justified in political rhetoric as a means to thwart the schemes of a class of people who were denigrated repeatedly as fly-by-night operators, fraudulent promoters, robbers, cancers, vultures, swindlers, grafters, crooks, goldbrick men, fakirs, parasites, confidence men, bunco artists, get-rich-quick Wallingfords, and so on. n285 Against this class of bad operators was counterpoised a class of victims, usually portrayed as innocent, weak minded, vacillating, foolish, or guileless, and usually cast in the roles of widows, orphans, farmers, little idiots or working people. n286 The [*390] justification for the statutes was therefore simple: the fraudulent salesmen were palming bad merchandise off on the innocent and unsophisticated public, and the blue sky laws were the way to stop the practice. Usually the statutes were supported in terms no more

sophisticated than this.

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n285. See, e.g., National Bond Dealers' Association, supra note 57, at 1941 (decrying such characters as "swindlers" and "unscrupulous speculators"); Promotion Schemes in Texas, supra note 86, at 1386 (warning of "crooks," "confidence men," "undesirables," and "grafters").

n286. See, e.g., Miller, supra note 44, at 3770 (characterizing the victims of securities fraud as "foolish," "weak minded," "innocent," and "vacillating," among other things).

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Beneath this rhetoric, so full of the epithets of the progressive movement, we may tease out three separate justifications for blue sky laws. Rephrased in today's analytic categories, these were: (1) preventing fraud in the sale of securities; (2) combating market failure arising from informational problems; and (3) paternalism.

A. Fraud

The social value of preventing fraud in the sale of securities is too clear to require elaboration. If buyers could not rely on the truthfulness of statements made by the sellers in connection with securities transactions, many otherwise beneficial transactions would not occur. The functioning of capital markets in facilitating capital formation would be severely impaired, to the detriment of issuers, buyers, and the economy at large. Thus, the prevention of fraud is a potentially appealing public-interest justification for these laws.

The justification for blue sky laws as fraud-prevention devices, however, is based on two empirical premises: first, that securities fraud was a significant problem at the time that was not being adequately addressed either by existing law or by market forces, and, second, that the blue sky laws were reasonably tailored to prevent such fraud. Neither of these premises is strongly borne out by the evidence.

There were, to be sure, many complaints about fraudulent securities promotions between 1910 and 1913, although they died off thereafter. Securities frauds unquestionably occurred during this period. The actual extent of fraudulent sales, however, is uncertain. Many of those complaining about securities fraud had an interest in exaggerating the extent of the problem, and their reports should be discounted accordingly. Further, the rhetoric of the times often labeled securities as "fraudulent" when, in all probability, they were merely highly speculative. And, although securities salesmen no doubt engaged in frequent puffery, they were in this respect acting no differently than salesmen of other goods. If actual fraud had been truly widespread, we would expect to see extensive evidence in the historical record of criminal prosecutions or private damages actions against fraudulent promoters. We simply do not find such evidence.

Small bankers and other proponents of blue sky laws frequently asserted that the purchasers of speculative securities were widows, orphans, [*391] or poor people. n287 Yet this claim was far-fetched. Widows, orphans, and poor

people did not have the money to buy speculative securities. In fact, the purchasers of these securities appeared to be, for the most part, members of a rising middle class and an established upper middle class -- including, apparently, numerous bankers n288 -- who had liquid wealth and who found low-interest bank deposit accounts to be unattractive forms of investment in a time of high nominal interest rates. These individuals appeared to be making a rational choice about what to do with their money. It is unlikely that they would confuse a speculative security -- such as an interest in a gold mine or venture to develop a new invention -- with a gilt-edged corporate bond. Moreover, if the securities in question were truly fraudulent, we would not expect customers to return to the poisoned well and get more. Yet customers frequently wanted to buy more securities, even if those purchased previously had not panned out. n289 There were so many repeat customers that an active trade in mailing lists of past purchasers of speculative securities grew up. n290

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n287. See supra text accompanying note 131.

n288. See E.S. Wagenheim, The Promoter and the Banker, 77 AM. BANKER 1875, 1875 (1912) (criticizing members of the banking profession whose investment in questionable securities lends credence to "schemes . . . to fleece the unwary").

n289. J. N. Dolley resorted to metaphor in explaining the Kansans' penchant for repeatedly purchasing speculative securities, observing: "The innocent investor might be compared to the fertile subsoil of the tropical regions. From it may be taken several crops a year without exhausting its infinite confidence." Dolley, supra note 65, at 1706.

n290. See supra text accompanying note 33.

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The available evidence suggests that many of the securities attacked by the proponents of blue sky legislation were not, in fact, inherently fraudulent. Among those securities alleged to be fraudulent were stock in metal mines, oil companies, gold mines, and cooperative farms, often sold by mail order at a low price per share. n291 Such securities were undoubtedly speculative, and many investors lost money in them. Yet some investors also profited. Many of the California oil firms denigrated as "speculative" by proponents of blue sky legislation were paying out large dividends in these years, and the success rate for exploratory wells was apparently quite high. n292 One thoughtful investment banker, analyzing the surge of speculative issues in 1912, observed that many of these involved the

promotion by inexperienced parties of what are known as "construction propositions;" that is to say, enterprises in process of establishment, as, for instance, the many irrigation systems whose bonds have been placed before the public during the last few years and whose [*392] completion in only a few cases has become a fact. And the same applies in many other lines. n293

Again, the evidence seems to indicate that the securities in question were not so much fraudulent as merely highly speculative.

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n291. See Matthews, supra note 33, at 175.

n292. Cf. John O. Dresser, The New Oil Industry in California, 82 BANKERS MAG. 494, 495 (1911).

n293. Carles et al., supra note 27, at 266.

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There is, to be sure, considerable evidence that state securities commissioners rejected large volumes of proposed offers during the early years of blue sky enforcement. Kansas Banking Commissioner J. N. Dolley reported in 1912 that he had rejected all but seventy of eight hundred applications to sell securities in his state. n294 His successor announced in 1915 that "Kansas' annual toll to get-rich-quick concerns has been reduced from $ 4,000,000 to less than $ 100,000" as a result of that state's blue sky law. n295 From 1915 to 1916, the California blue sky administrator approved securities totalling $ 246 million in selling price and disapproved $ 53 million in par value securities n296 -- and this in a state in which one would expect high levels of approval because of its significant petroleum and mining interests. The Michigan Securities Commission prevented the sale of over $ 200 million in securities between 1913 and 1918. n297 Between 1920 and 1923 the Nebraska securities commissioner rejected $ 51 million out of $ 200 million in securities for which license applications were filed. n298

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n294. See supra text accompanying note 82. But see supra notes 87-90 and accompanying text (discounting Dolley's claims).

n295. "Blue Sky" Law Effective in Kansas, 80 AM. BANKER 2715, 2715 (1915) (quoting S.T. Seaton, head of the "blue sky" department in the State Bank Commissioner's office).

n296. Gerald D. Nash, Government and Business: A Case Study of State Regulation of Corporate Securities, 1850-1933, 38 BUS. HIST. REV. 144, 156-57 (1964).

n297. Seligman, supra note 6, at 21. Seligman's data is taken from Note, Uniform Sale of Securities Act, 30 COLUM. L. REV. 1189, 1196 n.45 (1930) (citing REPORT OF THE MICHIGAN SECURITIES COMMISSION (1918)).

n298. Regulating the Sale of Securities, supra note 135, at 65 (statement of Commissioner Touvelle).

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Professor Seligman, the leading analyst of blue sky enforcement during the formative period, accepts such figures as indicating that "securities fraud was a substantial problem" in the states prior to the adoption of the Securities Act of 1933. n299 In truth, however, the large volume of rejected securities does not necessarily indicate high levels of fraud because of the enormous discretion involved in the decision to exclude a security, especially in states with

merit regulation.

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n299. Seligman, supra note 6, at 20.

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Some inkling of the actual bases for rejecting securities can be gleaned from the comments of an official in the Kansas blue sky department in 1918. Speaking to his fellow securities officials from other states, this administrator identified the following securities as ones that should be [*393] discouraged under wartime conditions: "[C]ompanies that propose to develop lands . . . by irrigation or drainage or by any other enhancing improvement or utility which necessarily will require time, labor, or capital"; "[e]nterprises for the manufacture and distribution of automobiles and pleasure cars"; "[e]nterprises for the erection of buildings"; and "[e]nterprises to develop or produce sales companies for the sale or distribution of luxurious commodities, goods or accessories." n300 To the applause of his fellow securities administrators, the official went on to boast:

As an evidence of the manner in which we have been trying to administer this law in the State of Kansas, having had a Blue Sky law now over seven years, at the present time the number of companies authorized under that law . . . is less than 250. The capital stock in these companies in my judgment will not average more than $ 100,000. This is the accumulation of over seven years' work. . . . I throw this in as a suggestion as to the amount of business that is being done in our state, which is I believe the pioneer in Blue Sky legislation. n301

Given the evidence that many of the securities rejected by state officials during the early years of the blue sky laws may not have been fraudulent, it appears that the data showing apparently high levels of enforcement do not, in themselves, establish the existence of a serious problem of securities fraud during the period in question.

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n300. NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS, PROCEEDINGS OF THE FIRST ANNUAL CONVENTION 47 (1918) (remarks of Special Assistant Bank Commissioner Organ).

n301. Id. at 47-48.

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Even if there was a serious problem with securities fraud, it is not clear that the Kansas-style blue sky laws were appropriate measures to combat the problem. A full disclosure statute -- perhaps with a system of administrative control of marketing such as that later incorporated into the federal Securities Act of 1933 n302 -- would appear, at least on the surface, better crafted to cope with fraud while allowing bona fide sales to continue. But the early Kansas-style blue sky statutes went further, giving state securities commissioners virtually unfettered discretion to reject proposed securities sales even when the sales literature made full disclosure of the risks. This appears grossly overinclusive. An argument might be made that the

overinclusiveness was necessary for reasons of administrative convenience, but it does not appear particularly persuasive. Thus, the need to combat securities fraud, at least standing alone, does not provide a convincing public policy justification for these statutes.

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n302. 15 U.S.C. @@ 77a-77aa (1988).

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[*394] B. Informational Problems

A different potential justification for these statutes is that they were designed to deal with severe informational problems in securities markets. n303 If consumers could not discover accurate information about the quality of securities offered for sale, a loss of confidence in securities markets generally might result. As one banking journal observed, "So many people have lost their money on 'fake' investments that they seem to be incapable of distinguishing the false from the genuine, and hence are distrustful of all." n304 This is a straightforward application of George Akerlof's "lemons" model for markets subject to large informational asymmetries. n305 Some good securities could have been driven off the market, to the detriment of the offering firm, the underwriters, and the public at large.

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n303. The rhetoric of blue sky laws did not clearly distinguish between the problem of actual fraud or misrepresentation, on the one hand, and the problem of public confusion and failure to differentiate between good and bad securities, on the other. A worthless or highly speculative security was typically labeled as fraudulent, even if the seller made no affirmative misrepresentations, because the security was seen as being palmed off on the public as a worthwhile investment, when in fact it was not.

n304. The Investment Bankers' Organization, 77 AM. BANKER 1302, 1303 (1912).

n305. See generally George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q.J. ECON. 488 (1970) (discussing generally the relationship between quality and uncertainty). Akerlof uses the used car market to illustrate the potential breakdown of a market system when informational asymmetries exist. See id. at 489-92.

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The problem of informational asymmetry provides a potentially plausible justification for the blue sky laws, but the analysis appears vulnerable in a number of respects. First, if a "lemons" problem actually existed, many potential buyers, unable to distinguish good investments from worthless ones, would respond by declining to invest at all. This does not appear to have been the case. In fact, it is not clear how serious the information problem was. It was probably not too difficult for someone seeking assurances of return to distinguish blue-chip bonds from stock in a new gold mining venture, for example. Moreover, there were vigorous efforts in the private sector to assist the public in distinguishing between good and bad securities. The New York

Stock Exchange began to insist on increasingly detailed disclosure as a precondition for listing on the exchange. n306 And quite apart from the information disclosed, the mere fact of listing on an exchange served as a signal of quality. n307 The [*395] elite investment bankers attempted to combat the "lemons" problem in 1912 by forming their own organization, the IBA, with a view, in part, toward establishing a reputation for reliability and integrity that the public could trust. n308 For the most part, a consumer could know a blue chip security when he or she saw one, although distinguishing among grades of more speculative securities could have remained difficult.

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n306. See NEW YORK STOCK EXCHANGE, MARKETPLACE: A BRIEF HISTORY OF THE NEW YORK STOCK EXCHANGE (1982) (reporting that after 1903 listing agreements on the NYSE became more rigorous, generally requiring that listed firms publish annual reports and quarterly income statements, prohibiting speculation by listed firms in their own securities, and mandating prior notice to shareholders on the exchange of new issues and actions on dividends). Even commentators otherwise highly critical of the securities industry, such as Harvard political scientist William Ripley, lauded the New York Stock Exchange as "[b]eyond peradventure . . . the leading influence in the promotion of adequate corporate disclosure the world over." RIPLEY, supra note 38, at 210.

n307. See Hideki Kanda & Jonathan Macey, The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges, 75 CORNELL L. REV. 1007, 1009-10 (1990).

n308. See The Investment Bankers' Organization, supra note 304, at 1303 (discussing the possible formation of an IBA, the calibre of people involved in its formation, and the impact such an organization would have on the industry's professionalism).

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Even if a serious informational problem remained despite these efforts to provide reliable signals of quality to consumers, however, it is not clear that Kansas-style blue sky legislation was well tailored to the goal of assuring quality. Although securities commissioners were authorized to reject a security simply because it was of low quality, it is not evident how the quality determination was to be made. Securities commissioners were not fortune tellers. They could not accurately predict which securities would do well and which would not. n309 Even when low-quality securities could be identified, it is not evident why a disclosure requirement would not have been equally efficacious at alerting consumers to the dangers of a particular issue, while not foreclosing the market entirely to consumers willing to take the risks in order to get a chance at the rewards.

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n309. If they could make such predictions, they probably would have taken up playing polo rather than sitting in an office reviewing applications and forms.

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C. Paternalism

A third possible justification for the blue sky laws -- one which would not find acceptance everywhere, but which nevertheless represents an important strain in the pattern of American law -- is paternalism. The argument would be that even if no fraud occurred in the sale of securities, and even if the consumer were fully informed about the riskiness of the securities in question prior to sale, there would still be a justification for regulation on the ground that the consumer simply did not know his or her own best interests.

Paternalistic justifications -- implicit in the repeated characterization of the purchasers of blue sky securities as widows and orphans -- can be found among supporters of the state blue sky statutes. The classic statement is that of J.N. Dolley, the father of blue sky regulation, who remarked: "It has been said that the people do not need a guardian to supervise their investments, but I want to say to you . . . that a large [percent] of them do need a guardian, especially in matters of this kind." n310 The President of [*396] the Florida Bankers' Association was even more explicit, recommending Kansas-style legislation on the ground that "[w]e should have some legislation in this State to protect the public against its own weakness. I refer to the means by which the public is tempted by the prospect of quickly acquired wealth, to part with its money in exchange for securities that are steeped in fraud." n311

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n310. Dolley, supra note 65, at 1705.

n311. Allen, supra note 109, at 1322. But see Smith, supra note 151, at 2998 (observing that the blue sky law "hardly squares with the old maxim, 'let the buyer beware,' that has made wits sharp and money conservative for centuries").

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Putting aside the question of whether paternalism is an appropriate justification for government intervention in markets, there remains the question of whether it could justify the Kansas-style blue sky laws. We have observed that many customers of securities appeared to be fully able to protect themselves against unwise investments. n312 On the other hand, many customers were also new at purchasing securities and probably were relatively unsophisticated at dealing with fast-talking securities salesmen. Accordingly, while we doubt that paternalism constituted an adequate reason for enacting blue sky laws, it seems possible that the blue sky movement's success would not have been possible but for strong feelings of paternalism among the lawmakers.

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n312. See supra notes 306-08 and accompanying text.

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Based on the above analysis, there appear to be at least two (three, if you accept paternalism) potential public interest justifications for blue sky

statutes. These justifications do not appear particularly strong, however, especially as applied to Kansas-style legislation with merit regulation. This Article has advanced evidence that blue sky legislation was promoted in the legislative process by a coalition of groups -- small banks, state banking supervisors, small businesses, and farmers -- which stood to benefit financially from the legislation. There would thus appear to be solid grounds for suspicion of these supposedly "public interest" rationales. Again, this is not to say that we find no evidence for the public interest rationales, only that the purpose and effect of the blue sky laws appear to have been far more heavily influenced by special private interests than standard historical accounts admit.

X. Conclusion

Standard histories portray blue sky laws as a public-spirited, spontaneous populist response to serious abuses in securities markets. The rapidity with which the states enacted blue sky legislation is taken to indicate the [*397] severity of the problem of fraudulent securities distributions. And the diffusion pattern of these laws is taken to indicate that where the economic might of the securities industry was not overwhelming -- that is, in rural states such as Kansas -- it was possible for states to adopt legislation intended to suppress securities fraud, even if the means chosen to accomplish the task may have been somewhat crude in the early statutes.

There is some plausibility to this standard account: the blue sky laws were undoubtedly popular at the grass-roots level in many states, and the efforts by regulators such as J.N. Dolley, and later by the state attorneys general, appear to have been motivated by an honest, even admirable sense of public service rather than any selfish or venal concerns. However, that account is incomplete. It fails to recognize that among the principal determinants of legislative behavior were the influence of organized special interests lobbying for or against different legislative proposals. To our knowledge, the literature has never fully explored this latter hypothesis.

We find that while there was a public-regarding element to these statutes -- securities fraud undoubtedly did occur during the period in question, and members of the public demanded protection against high-pressure securities salesmen with low business morals -- among the principal determinants of the spate of statutes between 1911 and 1913 was the rivalry between the political coalition favoring Kansas-style blue sky legislation, which included smaller banks, state banking commissioners, and local borrowers, and the coalition opposing such legislation, which included the elite investment houses, the large banks, and bond issuers such as major manufacturing firms, railroads, and public utilities. We also find that the interest group activity in question was extremely sensitive to economic conditions, tending to substantiate the hypothesis that interest groups are much more likely to seek legislative protection against competition when they are experiencing economic distress than when they are enjoying prosperity.

Our study questions the assumption made by prior writers that securities fraud was a significant problem during the period before the advent of specialized regulation. The actual extent of securities fraud during the period we study is unknown, but almost certainly was much lower than is assumed in the standard histories.

LEVEL 1 - 77 OF 96 ITEMS

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ARTICLE: Constitutional Fact and Process: A First Amendment Model of Censorial Discretion

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SUMMARY:

... The quotation sums up the usual perception among U.S. appellate courts as to their operative function and division of labor. ... Further, Justice Rehnquist was correct to point out that the earliest constitutional fact precedent more easily lends itself to being described as involving "the kind of mixed questions of fact and law which call for de novo appellate review than do the New York Times 'actual malice' cases, which simply involve questions of pure historical fact." ... More recently, a majority of the Court appears to read Bose as establishing something of a mixed law-fact analysis, for example as a justification for de novo review of findings on protected speech. ... This reasoning was reconfirmed in Harte-Hanks, in which the Court held that an independent review rule applies to courts reviewing jury verdicts as well: Although credibility determinations receive deference, the appellate court reviewing the factual record in full must examine for itself whether the statements and circumstances are of a character protected by the First Amendment and whether the constitutional standard has been satisfied. ...

The Supreme Court's "constitutional fact" doctrine traditionally empowers appellate courts to apply independent review in First Amendment cases. A closer examination of the cases that make up this tradition, including New York Times Co. v. Sullivan and Bose v. Consumers Union, reveals that the review rule may well apply even to historical facts and other issues far short of the ultimate "legal" conclusion in these cases. Yet scholars and lower courts almost uniformly read the tradition as merely confirming an appellate court's authority to decide legal or mixed law-fact questions. This is error, in part because

the Court's cases do not in fact limit their scrutiny to such conclusions, or do not involve questions that can fairly be described as legal. The review process instead rests on a proper error-correction function rather than simple law-declaration.

More broadly, the tradition actually draws on an accepted and heightened procedural component of First Amendment protection, as well as a pre-constitutional history of locating decisionmaking power within a skeptical judicial body when important speech interests are challenged. The Article thus asserts that constitutional fact review properly embraces and reflects its true First Amendment origins, and today properly enforces recognized speech policy. It urges a new model of censorial discretion to explain and justify such procedural anomalies, and to rectify a series of lower court errors following Bose and Sullivan. The model posits that exercises of factfinding discretion at trial are potential acts of censorship, apart from the substantive line drawing of traditional First Amendment theory, and that other judicial actors on review must be imbued with their own factfinding discretion to prevent manipulation, abuse, and error. Ultimately, the Article argues, much more is at stake than routine appellate procedure. Process in speech cases is special, protectionist, and appropriately skeptical of judicial discretion.

TEXT:

[*1231] [EDITOR'S NOTE: PART 1 OF 2. THIS DOCUMENT HAS BEEN SPLIT INTO MULTIPLE PARTS ON LEXIS TO ACCOMMODATE ITS LARGE SIZE.]

I. INTRODUCTION

A. The Reviewing Court in Three Acts

"All appellate Gaul, the trial judge would say, is divided into three parts: review of facts, review of law, and review of discretion."

--Maurice Rosenberg, Appellate Review of Trial Court Discretion,

79 F.R.D. 173, 173 (1978).

The quotation sums up the usual perception among U.S. appellate courts as to their operative function and division of labor. Of course, the distinction is somewhat artificial, as law, fact, and discretion may be said to occupy three sides of one strange coin. Or at least in the application of appellate judicial decisionmaking, they often overlap like the circus ringmaster's three spotlights.

To the extent that a distinction among forms of review can be drawn in cases, the effort has important consequences. Appellate courts determine law without deference to the lower court's decision, n1 they defer to the findings of fact, n2 and they defer inconsistently (as Rosenberg himself initially observed) to exercises of judicial and procedural discretion. n3

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n1 See, e.g., Salve Regina College v. Russell, 499 U.S. 225 (1991); Miller v. Fenton, 474 U.S. 104 (1985).